

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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[fol. 1] **IN THE UNITED STATES COURT
OF APPEALS FOR THE SIXTH CIRCUIT**

No. 12247

AUTOMOBILE CLUB OF MICHIGAN, Petitioner and Appellant,

vs.

**COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee**

Appeal from the Tax Court of the United States

Appendix for Appellant

[fol. 2] **BEFORE THE TAX COURT OF THE UNITED STATES**

Docket Entries

1952

Sept. 16. Hearing had before Judge Withey on the merits; filed at hearing, petitioner's motion for leave to file amended petition, granted, served; amended petition, served; answer to amended petition, served; appearance of Raymond H. Berry, Esq., and A. H. Moorman, Jr., Esq.; briefs due 11/17/52; replies due 12/17/52; stipulation of facts with petitioner's Exhibits 1 through 22 and Respondent's Exhibits A and B.

Sept. 29. Transcript of hearing 9/16/52 filed.

1953

Apr. 16. Brief filed by General Counsel; served at counter 4/17/53.

Sept. 23. Findings of fact and opinion rendered; Judge Withey; decision will be entered under Rule 50; copy served.

[fol. 3] BEFORE THE TAX COURT OF THE UNITED STATES

Amended Petition—Filed September 16, 1952

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols: Detroit Division: IT Conf.) dated February 2, 1950 and as the basis of this proceeding alleges as follows:

1. Petitioner, Automobile Club of Michigan, is a non-profit corporation organized and existing under and by virtue of the laws of the State of Michigan with its principal place of business at 139 Bagley Avenue, Detroit 26, Michigan.

2. The corporation's income tax returns, excess profits tax returns, and declared-value excess profits tax returns for the taxable years here involved were filed with the Collector of Internal Revenue for the District of Michigan at Detroit, Michigan.

3. The notice of deficiency, a copy of which is attached hereto and marked Exhibit A, was mailed to petitioner on February 2, 1950.

4. The taxes in controversy are corporation income taxes and corporation excess profits taxes for the calendar years 1943 to 1947, inclusive, in the aggregate amount of \$447,445.44 as follows:

Years	Income Tax	Excess Profits Tax
1943.....	\$ 49,016.97	\$128,953.72
1944.....	48,781.99	157,307.29
1945.....	42,373.66	.....
1946.....	13,645.94	.....
1947.....	7,365.87	.....
	<hr/>	<hr/>
	\$161,184.43	\$286,261.01

[fol. 4] 5. The determination of taxes set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in determining that the Automobile Club of Michigan is not an organization exempt from taxes for the taxable years 1943 to 1947, inclusive, under the provision of Section 101 of the Internal Revenue Code.

(b) The Commissioner of Internal Revenue erred in holding that the entire amount of membership dues received by petitioner during each of the taxable years 1943 to 1947, inclusive, must be included in income for the year of receipt under the provisions of Sections 41 and 42 of the Internal Revenue Code.

(c) The Commissioner of Internal Revenue erred in changing the method of accounting regularly employed in keeping the books of the petitioner with respect to membership dues from the accrual to the cash basis.

(d) The Commissioner of Internal Revenue erred in determining that gross income should be increased for the years 1943 to 1947, inclusive, by the following amounts representing the alleged difference in reporting membership dues on the cash basis rather than on the accrual basis:

1943	.....	\$132,935.67
1944	.....	84,023.19
1945	.....	78,515.41
1946	.....	172,924.05
1947	.....	85,356.41

and in failing to determine that gross income should be increased for the years 1943 to 1947, inclusive, by the following amounts of membership dues actually received, if taxable on the cash basis rather than on the accrual basis:

[fol. 5-6] 1943	.....	\$132,742.37
1944	.....	82,879.34
1945	.....	77,198.81
1946	.....	145,919.02
1947	.....	64,523.82

(e) The Commissioner of Internal Revenue erred in failing to determine that if petitioner's accounts are to be placed on a cash basis in respect to membership dues, its accounting for advertising revenues should likewise be placed on a cash basis and advertising revenues should be taken into gross income when received rather than as earned.

[fol. 7] (p) The Commissioner of Internal Revenue erred in determining deficiencies in corporation income tax and corporation excess profits tax against petitioner for the years 1943, 1944 and for the period January 1, 1945 to July 16, 1945 retroactively, petitioner having been specifically exempted from payment of taxes or filing returns for said periods.

(q) The Commissioner of Internal Revenue erred in determining deficiencies in corporation income and excess profits taxes for the years 1943 and 1944 in any amount whatsoever since he was barred by the tolling of the Statute of Limitations from making such determination.

(r) The Commissioner of Internal Revenue erred in determining that there are deficiencies in corporation income tax and corporation excess profits tax due from petitioner for the years 1943 to 1947, inclusive, in any amount whatsoever.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner is a non-profit corporation organized and existing under and by virtue of the laws of the State of Michigan and upon a non-share basis. Its [fol. 8] principal place of business is at 139 Bagley Avenue, Detroit 26, Michigan. The corporate charter remains in full force and effect at the date hereof.

(b) Petitioner was organized as an automobile club, and is supported by members' subscriptions, the receipts from which, together with the receipt of money from other sources, were and are used to assist in securing the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent

highways; to interest automobile owners and drivers in the principles of safety as applied to traffic; to promote touring and to obtain and furnish touring information; to provide and promote the necessary sign-boarding of public highways and streets; to furnish emergency road service to automobile owners; to secure accurate information relative to Michigan's recreational facilities and to properly distribute such information; to cooperate with any work or movement which will tend to benefit the automobile driver, user, owner or manufacturer; and to furnish any and all other service that may be demanded by or prove beneficial to automobile owners in general.

(c) The functions of petitioner are carried out by its officers and employees under the direction of a Board of Directors which is elected each year and holds regular meetings. The members of the Board of Directors serve without compensation.

(d) The membership of petitioner consists of honorary members, life members and active members. During the years here involved active members were required to pay annual dues of \$10.00, which was increased to \$12.00 effective October 1, 1946. The number of active members belonging to petitioner club for said years was as follows:

[fol. 9-12] 1943	212,865
1944	224,092
1945	243,630
1946	261,695
1947	244,994

(e) The money received from dues and from other sources is used solely to provide services for the benefit of petitioner's members and no part thereof is distributed to the members or other persons, except as salaries to employees for services rendered by them.

(f) The Bureau of Internal Revenue issued a ruling under date of June 11, 1934, that petitioner was entitled to exemption from Federal income tax under the provisions of Section 103 (9) of the Revenue Act of 1932. This ruling was reaffirmed on July 5, 1938, under the provisions of the Revenue Act of 1936. Under date of

July 16, 1945, the Deputy Commissioner of Internal Revenue issued a letter addressed to petitioner revoking the exempt status of petitioner and requiring it to file tax returns retroactively for the years 1943 and 1944 and for subsequent years.

(g) In compliance with the requirement of the Deputy Commissioner of Internal Revenue in his letter of July 16, 1945, petitioner filed corporation income tax, excess profits tax and capital stock tax returns for the years 1943 and 1944 and subsequently for all later years with the Collector of Internal Revenue for the District of Michigan at Detroit, Michigan. The corporation income tax returns and excess profits tax returns filed by petitioner for each of the years here involved were filed under protest and did not reflect any tax as due thereon, it being the position of petitioner that it was exempt from said taxes. Capital stock tax returns were filed and the tax shown thereon was paid.

[fol. 13] (p) Petitioner filed a return for the calendar year 1943 on Form 990 as required by the Regulations of Commissioner of Internal Revenue on or about August 7, 1944, and a return for the calendar year 1944 on Form 990 on or about May 11, 1945. Said returns constituted returns within the meaning of Section 275 of the Internal Revenue Code and the filing thereof started the running of periods of limitation for the assessment of taxes under Chapter 1 and Chapter 2 E of the Internal Revenue Code.

(q) Petitioner has always regularly kept its books of account on the accrual basis. With reference to membership dues, petitioner has consistently followed the practice of crediting dues as received (except for the amount of \$1.00 of such dues treated as the subscription price of its membership magazine) to a deferred income account and has taken such dues into income only as they were earned. Any member of the club who resigned during the period of his membership is entitled to receive and does receive a refund of the unearned portion of the dues paid by him. The membership dues earned by petitioner during the years here involved and properly constituting items of gross

income for said years were correctly reported on its corporation income and excess profits tax returns.

(r) Petitioner is entitled to determine its excess profits credit either on the invested capital basis or on the average earned basis whichever method produces the greater credit. In the event that receipts from membership dues are taken into income only when earned, petitioner will be entitled to compute its excess profits credit on the basis of its average base period net income. If petitioner is required to report its dues as [fol. 14] income when received, it will be entitled to compute its excess profits credit upon the invested capital basis. Petitioner's invested capital at January 1, 1943 was in an amount not less than \$2,293,309.52 and its excess profits credit on the invested capital basis for 1943 was not less than \$183,464.76.

(w) In the event petitioner's membership dues are taken into account when received, as determined by the Commissioner, the amounts of such dues received by petitioner during the years here in question were greater than the dues shown on the returns by the following amounts:

[fol. 15]	1943.....	\$132,742.37
	1944.....	82,879.34
	1945.....	77,198.81
	1946.....	145,919.02
	1947.....	64,523.82

(x) During the years here in question petitioner credited certain of its advertising revenues to a deferred income account. In the event such advertising revenues were taken into gross income when received, petitioner's gross income for the years 1943 to 1945 inclusive, would be reduced below the amounts determined by the Commissioner by the following amounts:

1943.....	\$267.25
1944.....	945.48
1945.....	330.00

Wherefore, petitioner prays that this Court may hear the proceeding and determine that there are no deficiencies due

from petitioner for corporation income tax or for corporation excess profits tax for any of the years from 1943 to 1947, inclusive, in any amount whatsoever.

Dated: Detroit, Michigan, September 4, 1952.

"Raymond H. Berry", "Ralph W. Barbier",
 "Donald D. MacFarlane", "A. H. Moorman, Jr.",
 "Roy Tolleson, Jr.", Attorneys for Petitioner,
 1000 Penobscot Building, Detroit 26, Michigan.

[fol. 16] *Duly sworn to by J. C. Sasser, jurat omitted in printing.*

[fol. 17] **Exhibit "A" to Amended Petition.**

Form 1279 (Rev. July 1949)

**TREASURY DEPARTMENT
 INTERNAL REVENUE SERVICE**

February 2, 1950

Office of
INTERNAL REVENUE

Agent in Charge
 Detroit Division

1800 Penobscot Bldg.
 Detroit 26, Michigan
 IT:Conf.

Automobile Club of Michigan
 139 Bagley Avenue
 Detroit 26, Michigan

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years 1943, 1944, 1945, 1946 and 1947, discloses deficiencies in the total amount of \$161,184.43; and that the determination of your excess profits tax liability for the taxable years 1943 and 1944,

discloses deficiencies in the total amount of \$286,261.01, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Detroit 26, Michigan for [fol. 18] the attention of IT:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

Geo. J. Schoeneman, Commissioner,

By Geo. E. Neal, Internal Revenue Agent in Charge

Enclosures:

Statement
Form of Waiver

IT:Conf.

STATEMENT

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

TAX LIABILITY FOR TAXABLE YEARS ENDED
December 31, 1943 to 1947, Inclusive

INCOME TAX

Years	Liability	Deficiency
1943.....	\$ 49,016.97	\$ 49,016.97
1944.....	48,781.99	48,781.99
1945.....	42,373.66	42,373.66
1946.....	13,645.94	13,645.94
1947.....	7,365.87	7,365.87
Totals.....	\$161,184.43	\$161,184.43

EXCESS PROFITS TAX		
1943.....	\$128,953.72	\$128,953.72
1944.....	157,307.29	157,307.29
Totals.....	\$286,261.01	\$286,261.01

[fol. 19] In making this determination of your income and excess profits tax liability, careful consideration has been given to the reports of examination dated January 8, 1947, and April 2, 1948; to your protests received June 9, 1947, and June 29, 1948, and to the statements made at conferences held on July 25, 1947, April 5, 1949, August 3, 1949, and October 19, 1949.

Automobile Club of Michigan

—2—

Statement

It is determined that the Automobile Club of Michigan is not an organization exempt from taxation for the taxable years 1943 to 1947, inclusive, under the provisions of Section 101(9) of the Internal Revenue Code.

It is held that the entire amount of membership dues received during the taxable years 1943 to 1947, inclusive, must be included in income for the years of receipt under the provisions of Sections 41 and 42 of the Internal Revenue Code and net incomes have therefore been increased in several years as follows:

Year	Amount
1943	\$132,935.67
1944	84,023.19
1945	78,515.41
1946	172,924.08
1947	85,356.41

Depreciation as claimed on returns for the taxable years 1943 and 1947, inclusive, have been determined to be in excess of that allowable under the provisions of Section 23(1) of the Internal Revenue Code and disallowances as more fully explained in detail in exhibit attached hereto have been made in the following amounts:

Year	Amount
1943	\$ 1,066.59
1944	1,066.59
1945	1,066.59
1946	1,066.59
1947	22,115.26

[fol. 20] The excess profits credits shown on your returns, which are based on the income method, have been used in the computations of the deficiencies set forth herein, inasmuch as the issues in controversy have a bearing on the method to be used.

Automobile Club of Michigan

—3—

Statement

A copy of this letter and statement has been mailed to your representatives, Mr. Raymond H. Berry, 1000 Penobscot Building, Detroit 26, Michigan, and Mr. Taylor H. Soeber, 2000 Buhl Building, Detroit 26, Michigan, in accordance with authority contained in a power of attorney executed by you and on file in the Bureau.

BEFORE THE TAX COURT OF THE UNITED STATES

Answer to Amended Petition—Filed September 16, 1952

Comes now the Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to amended petition filed herein, admits, denies, avers and affirmatively alleges as follows:

1. Admits that the petitioner, Automobile Club of Michigan, is a corporation organized and existing under and by virtue of the laws of the State of Michigan with its office

and principal place of business at 139 Bagley Avenue, Detroit 26, Michigan. Denies the remaining allegations contained in paragraph 1 of the amended petition.

2 and 3. Admits the allegations contained in paragraphs 2 and 3 of the amended petition.

4. Admits that the taxes in controversy are income tax for the taxable years ended December 31, 1943, 1944, 1945, 1946 and 1947, and excess profits tax for the taxable years ended December 31, 1943 and 1944, as alleged in paragraph 4 of the amended petition, in the following respective amounts:

[fol. 21]

Year	Income Tax	Excess Profits Tax
1943	\$ 49,016.97	\$128,953.72
1944	48,781.99	157,307.29
1945	42,373.66	—0—
1946	13,645.94	—0—
1947	7,365.87	—0—
	<hr/> \$161,184.43	<hr/> \$286,261.01

5. (a) to (p), inclusive. Denies that the Commissioner erred as alleged in subparagraphs (a) to (p), inclusive, of paragraph 5 of the amended petition.

(q) Denies that the Commissioner erred as alleged in subparagraph (q) of paragraph 5 of the amended petition; and avers that petitioner, Automobile Club of Michigan, duly executed and delivered to the respondent the following successive consents fixing the period of limitation upon assessment of its income and excess profits taxes (Form 872) whereby it consented and agreed that the amounts of any income, excess profits or war profits taxes due under any return made by or on behalf of said corporation for the taxable years ended December 31, 1943 and 1944, could be assessed at any time shown below:

Year	Date of Consents	Expiration Date of Consents
1943	August 25, 1948	June 30, 1949
	May 23, 1949	June 30, 1950
1944	August 25, 1948	June 30, 1949
	May 23, 1949	June 30, 1950

The said consents were duly and timely accepted and executed by the respondent and the notice of deficiency, which

forms the basis of this proceeding, was mailed to the petitioner on February 20, 1950, before the expiration dates of the last consents as above indicated.

5. (r) Denies that the Commissioner erred as alleged in subparagraph (r) of paragraph 5 of the amended petition. [fol. 22] Denies the allegations of fact contained in subparagraphs (a) to (e), inclusive, of the unnumbered paragraph commencing with the second paragraph on page 7 of the amended petition.

(f) Admits the allegations of fact contained in subparagraph (f) commencing at the bottom of page 8, of said unnumbered paragraph of the amended petition.

(g), (h) and (i) Denies the allegations of fact contained in subparagraphs (g), (h) and (i) commencing on page 9 of said unnumbered paragraph of the amended petition.

(j) Admits that on April 12, 1926 the petitioner acquired the lessee's interest in a lease on premises at 139 Bagley Avenue, Detroit, Michigan, which lease was dated June 19, 1916, and was for a term commencing June 1, 1916, and terminating ninety-nine years thereafter, and that the consideration which the petitioner paid for the assignment of such lease was \$275,000.00. Denies the remaining allegations of fact contained in subparagraph (j) appearing on page 11 of said unnumbered paragraph of the amended petition.

(k) Admits that prior to December 31, 1936, petitioner capitalized on its books additions to the furniture and fixtures account and the leasehold improvements and building alterations account, and periodically made provision for depreciation and amortization with respect thereto. At December 31, 1936, the petitioner charged to its surplus account the undepreciated balance of these accounts. Admits further that the cost of the leasehold interest which the petitioner acquired on premises at 139 Bagley Avenue, Detroit, Michigan, on April 12, 1926, was \$275,000.00, which the petitioner paid in annual installments, the last of which installment was made on or about July 1, 1941, and that petitioner charged off to expense such amounts of installments in the years in which they were made. Admits further that both prior to December 31, 1936, and subsequent to that date, petitioner capitalized on its books additions to

the automobiles and trucks account and periodically made provision for depreciation with respect thereto on the [fol. 23] basis of a four-year life. Denies the remaining allegations of fact contained in subparagraph (k) appearing on page 11 of said unnumbered paragraph of the amended petition.

(l) Denies the allegations of fact contained in subparagraph (l) appearing at the top of page 12 of said unnumbered paragraph of the amended petition.

(m) Admits that the term of the lease on the premises at 139 Bagley Avenue, Detroit, Michigan, was for a term of ninety-nine years commencing June 1, 1916; that petitioner acquired the lease on April 12, 1926; and further admits that at January 1, 1943, the lease had an unexpired term of seventy-two years and five months. Denies the remaining allegations of fact contained in subparagraph (m) appearing on page 12 of said unnumbered paragraph of the amended petition.

(n) to (x), inclusive. Denies the allegations of fact contained in subparagraphs (n) to (x), inclusive, commencing on page 12 of said unnumbered paragraph of the amended petition.

6. Denies generally and specifically each and every allegation in the amended petition not hereinbefore expressly admitted, qualified or denied.

Further Answering, respondent affirmatively alleges, particularly with reference to subparagraph (q) of paragraph 5 of the amended petition, as follows:

7. Respondent reiterates the statements and allegations contained in subparagraph (q) of paragraph 5 as stated on page 2 of this answer to amended petition, and, in further reference thereto, alleges that the petitioner, during the taxable years ended December 31, 1943 and 1944, was in receipt of gross income of over \$2,000,000.00, for each — such taxable years. The petitioner, having failed to file Federal tax returns for the taxable years ended December 31, 1943 and 1944, as a consequence omitted reporting such gross income in those years which amounts were properly includible therein, and, therefore, the resulting income and excess profits tax for said years may be assessed at any time within five years after the tax returns for the tax-

able years ended December 31, 1943 and 1944 were due to be filed, all in accordance with section 275(c) of the Internal Revenue Code. The respondent further shows that the petitioner filed no returns for the taxable years ended December 31, 1943 and 1944, as required by section 52(a) of the Internal Revenue Code until October 22, 1945. As a consequence, the respondent was not precluded from determining deficiencies until three years after such returns were filed under the provisions of section 275(a) of the Internal Revenue Code. Since the respondent and the petitioner agreed, under the provisions of section 276(b) of the Internal Revenue Code, to extensions to June 30, 1950, of the period of assessment, as shown in subparagraph (q) of paragraph 5 of this answer to amended petition, the notice of deficiency which forms the basis of this proceeding with respect to both taxable years was timely mailed on February 20, 1950.

Further answering, respondent affirmatively alleges as follows:

8. In the event that petitioner's excess profits credit for the years 1943, 1944 and/or 1945 is held to be larger than that allowed by the respondent in the deficiency notice and as a result thereof, under the provisions of the Internal Revenue Code, the amount of the deficiency or deficiencies in income tax for the years 1943, 1944 and/or 1945 will be more than that determined by respondent in the deficiency notice which forms the basis of this proceeding, then, in the alternative, with respect to such year or years, respondent avers that the amount of said deficiency or deficiencies in income tax for the years 1943, 1944 and/or 1945 should be increased by such amount or amounts.

Wherefore, it is prayed that the appeal be denied; and that the respondent's determination be in all respects approved, or, in the alternative, with respect to the years 1943, 1944 and/or 1945, that the Court determine an increased deficiency or deficiencies in income tax for the years 1943, 1944 and/or 1945 as heretofore alleged, claim for [fol. 25] which is hereby made pursuant to the provisions of section 272(e) of the Internal Revenue Code.

Charles W. Davis, Chief Counsel Bureau of Internal Revenue.

Of Counsel:

Thos. F. Callahan, District Counsel,
A. J. Friedman, Special Attorney, Bureau of Internal
Revenue.

AJF:tej 9-16-52

BEFORE THE TAX COURT OF THE UNITED STATES

Stipulation of Facts—Filed September 16, 1952

It is hereby stipulated and agreed by and between the parties hereto by their respective attorneys that the following facts shall be taken as true and that the same will be considered as offered in evidence in this proceeding, provided, however, that this stipulation shall be without prejudice to the right of either party hereto to introduce other and further evidence not inconsistent with the facts herein stipulated to be true:

1. The petitioner, Automobile Club of Michigan, was incorporated under the laws of the State of Michigan on July 21, 1916. Its name was originally Detroit Automobile Club. It assumed its present name on July 24, 1930. Petitioner's principal office and place of business is at 139 Bagley Avenue, Detroit, Michigan. A true copy of petitioner's articles of association with amendments thereto is attached hereto and is marked Exhibit 1. The purposes and activities of petitioner are set forth in its by-laws, a true copy of which is attached hereto and is marked Exhibit 2.

Exhibit 2 consists of three parts as follows: Exhibit 2, by-laws effective January 19, 1940, with amendments dated January 28, 1941 and April 7, 1942; Exhibit 2(a), by-laws [fol. 26] as amended effective March 15, 1947; and Exhibit 2(b), by-laws as further amended, effective May 20, 1947.

2. The functions of petitioner are carried out by its officers and employees under the direction of a board of directors which is elected annually. The members of the board of directors serve without compensation.

3. During the early part of 1934, petitioner inquired of respondent as to whether it was exempt from payment of

capital stock tax imposed by Section 215 of the National Industrial Recovery Act. On May 16, 1934, respondent wrote a letter to petitioner in reference to the inquiry and stated that in order to determine whether petitioner was entitled to exemption from payment of the capital stock tax imposed by Section 215 of the National Industrial Recovery Act, he must first determine whether petitioner was entitled to exemption for Federal income taxation under the provisions of Section 103 of the Revenue Act of 1932. Accordingly, respondent requested petitioner to supply certain information concerning its operations. A true copy of the letter of May 16, 1934, is attached hereto and is marked Exhibit 3.

4. On May 24, 1934, petitioner wrote respondent a letter and enclosed therewith a balance sheet showing the assets and liabilities of petitioner as of April, 1934. A true copy of the letter of May 24, 1934, and the balance sheet as of April, 1934, are attached hereto and are marked Exhibit 4.

5. On June 11, 1934, respondent wrote a letter to petitioner, a true copy of which is attached hereto and is marked Exhibit 5.

6. On September 29, 1937, respondent sent petitioner a questionnaire and requested it to supply certain information concerning its claim for exemption under Section 101(9) of the Revenue of 1936. The petitioner filled in the questionnaire, signed it, and returned it to respondent with a letter dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936. True copies of the documents referred to are attached hereto and marked Exhibit 6.

[fol. 27] 7. The respondent wrote a letter to the petitioner on July 5, 1938, a true copy of which is attached hereto and is marked Exhibit 7.

8. On May 12, 1945, respondent wrote a letter to petitioner wherein he stated that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations for Federal income taxation and requested petitioner to supply further information concerning its operations. A true copy of the letter of May 12, 1945 is attached hereto and is marked Exhibit A.

9. On June 11, 1945, petitioner wrote a letter to respondent in reply to its letter of May 12, 1945, and enclosed therein an Exemption Affidavit (Form 1025), signed June 2, 1945, together with a balance sheet of petitioner's condition as of December 31, 1944, and also a copy of petitioner's articles of incorporation and by-laws. True copies of the letter of June 11, 1945, the exemption affidavit and the balance sheet as of December 31, 1944, are attached hereto and are marked Exhibit 8.

10. On July 16, 1945, respondent wrote a letter to petitioner notifying it that the Bureau rulings contained in the letters of June 11, 1934 (Exhibit 5) and July 5, 1938 (Exhibit 7) were revoked and that the petitioner was required to file Federal tax returns for the taxable year 1943 and subsequent years. A true copy of the letter dated July 16, 1945, is attached hereto and marked Exhibit B.

11. On November 5, 1945, the law firm of Berry and Stevens, 1000 Penobscot Building, Detroit 26, Michigan, wrote a letter to respondent as follows:

[fol. 28] "Honorable Norman D. Cann
Deputy Commissioner of Internal Revenue
Washington, D. C.

In re: Automobile Club of Michigan
Detroit, Michigan

Symbols:IT:P:T:1:FDF

Dear Sir:

This is to advise you that the Automobile Club of Michigan has filed the following returns with the Collector of Internal Revenue at Detroit:

1. 1943 capital stock tax return with which the tax of \$4,062.50 was paid.
2. 1944 capital stock tax return with which the tax of \$4,375.00 was paid.
3. 1945 capital stock tax return with which the tax of \$4,375.00 was paid.

The foregoing returns were filed and the taxes paid under protest.

4. Corporation income and declared value excess profits tax return for the calendar year 1943.

5. Corporation excess profits tax return for the calendar year 1943.

6. Corporation income and declared value excess profits tax return for the calendar year 1944.

7. Corporation excess profits tax return for the calendar year 1944.

The last mentioned returns were filed under protest and no tax was paid for the reason that we maintain that the Club is exempt from tax. The returns were filed in conformity with the request contained in your letter of July 16, 1945, directed to the Automobile Club of Michigan.

[fol. 29] It would be appreciated if all the returns might be subjected to an early examination by the Revenue Agent.

Very truly yours,

(signed) R. H. Berry

RHB:od

cc to Internal Revenue Agent in Charge
Detroit, Michigan"

12. Attached hereto is a schedule of the balance sheets of petitioner showing its assets and liabilities as recorded on its books for each of the years ended December 31, 1934 through December 31, 1941, which schedule is marked Exhibit 9.

13. Attached hereto is a schedule of the balance sheets of petitioner showing its assets and liabilities as recorded on its books for each of the years ended December 31, 1942 through December 31, 1947, which schedule is marked Exhibit 10.

14. Attached hereto is a schedule of petitioner's profit and loss as recorded on its books for each of the years 1934 through 1941, which schedule is marked Exhibit 11.

15. Attached hereto is a schedule of petitioner's profit

and loss as recorded on its books for each of the years 1942 through 1947, which schedule is marked Exhibit 12.

* 16. True copies of petitioner's Federal tax returns filed by petitioner are attached hereto and are marked as follows:

Exhibit 13. Corporation income and declared value excess profits tax return (Form 1120) for the taxable year 1943.

Exhibit 14. Corporation excess profits tax return (Form 1121) for the taxable year 1943.

Exhibit 15. Corporation income and declared excess profits tax return (Form 1120) for the taxable year 1944.

[fol. 30] Exhibit 16. Corporation excess profits tax return (Form 1121) for the taxable year 1944.

Exhibit 17. Corporation income and declared value excess profits tax return (Form 1120) for the taxable year 1945.

Exhibit 18. Corporation excess profits tax return (Form 1121) for the taxable year 1945.

Exhibit 19. Corporation income tax return (Form 1120) for the taxable year 1946.

Exhibit 20. Corporation income tax return (Form 1120) for the taxable year 1947.

17. On August 12, 1944, petitioner filed Form 990

(Treasury Department, Internal Revenue Service) in the office of the Collector of Internal Revenue at Detroit, Michigan, for the calendar year 1943, as required by Section 54 (f) of the Internal Revenue Code; and filed a like form on May 17, 1945, for the calendar year 1944. Photostat copies of the forms so filed are attached hereto and marked Exhibit 21.

18. The corporation income and excess profits tax returns filed by petitioner for the years in issue were prepared on the basis of a calendar year and on the accrual method of accounting.

19. The persons who avail themselves of the services offered by petitioner and who join petitioner's organization are designated as members. Such members are classi-

fied into three groups, viz, honorary members, life members and active members. During the years here involved, active members paid annual dues of \$10.00, except that such amount was increased to \$12.00 effective October 1, 1946. The number of members belonging to petitioner during the years in question was approximately as follows:

1943.....	212,865
1944.....	224,092
1945.....	243,630
1946.....	261,695
1947.....	244,994

[fols. 31-34] 20. Respondent has determined that petitioner's membership dues should be taken into income when received. In the event the respondent's determination in this regard is sustained, the correct amount of petitioner's income from membership dues is as follows:

1943.....	\$2,126,437.50
1944.....	2,237,017.04
1945.....	2,430,543.97
1946.....	2,744,897.65
1947.....	2,914,028.76

Petitioner's position is that it earned the membership dues ratably over the period of the membership, and that such dues should be taken into account upon a monthly basis over the period of such membership and not on the basis of when such dues were received. Petitioner's returns were prepared on this basis. In the event petitioner is sustained in this regard, the correct amount of petitioner's income from membership dues is as follows:

1943.....	\$1,993,695.13
1944.....	2,154,137.70
1945.....	2,353,345.16
1946.....	2,598,978.63
1947.....	2,849,504.94

21. In the event it is decided that petitioner is required to take membership dues into income when received, its income from advertising revenues would be reduced below

the amount reported in petitioner's income tax returns by the following amounts:

1943.....	\$267.25
1944.....	945.48
1945.....	330.00

[fol. 35] Raymond H. Berry, Counsel for Petitioner,
Charles W. Davis, Chief Counsel Bureau of Internal
Revenue, Counsel for Respondent.

[fol. 36] **Exhibit 1 to Stipulation of Facts**

Articles of Association
of the
"Detroit Automobile Club."

We, the undersigned, being of full age, and desiring to become incorporated under the provisions of Act. No. 171, of the Public Acts of Michigan for 1903, entitled "An act for the incorporation of associations not for pecuniary profit," do hereby make, execute and adopt the following articles of association, to wit:

Article I.

The name or title by which said corporation is to be known in law is the Detroit Automobile Club.

Article II.

The purpose or purposes for which it is formed are as follows: To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First," as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign boarding of public highways; and to co-operate in any work or movement which may tend to benefit

the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

Article III.

The principal office or place of business shall be at Detroit, in the County of Wayne.

Article IV.

The term of existence of this proposed corporation is fixed at thirty years from date of these articles.

[fol. 37]

Article V.

The number of Trustees or Directors shall be fifteen.

Article VI.

The names of the Trustees or Directors selected for the first year of its existence are as follows:

M. L. Pulcher, Edward N. Hines, E. P. Hammond, Edward Bleil, L. D. Robertson, Alfred O. Dunk, William E. Metzger, Alexander W. Copland, W. B. Bachman, Harry J. Porter, Wm. S. Bryant, Earl F. Jackson, William D. Rockwell, Bert Morley and M. C. DeWitt.

Article VII.

The qualifications required of officers and members are as follows:

Any white male person over the age of twenty-one years, and of good moral character.

In Witness Whereof, we, the parties hereby associating, have hereunto subscribed our names this 21st day of July A. D. 1916.

Names

M. L. Pulcher
E. P. Hammond
L. D. Robertson
William E. Metzger
W. B. Bachman
Wm. G. Bryant
William D. Rockwell

Names

Edward N. Hines
G. Edward Bleil
Alfred O. Dunk
Alexander W. Copland
Harry J. Porter
Earl F. Jackson
Bert Morley

M. C. DeWitt.

State of Michigan,
County of Wayne—ss.

On this 21st day of July A. D. 1916, before me, a Notary Public in and for said County, personally appeared Edward N. Hines, L. D. Robertson, Alfred O. [fol. 38] Dunk, William E. Metzger, Alexander W. Copland, W. B. Bachman, Harry J. Porter, William G. Bryant, Earl F. Jackson, known to me to be the persons named in, and who executed the foregoing instrument, and severally acknowledged that they executed the same freely and for the intents and purposes therein mentioned.

Delia Pichette, Notary. Public, Wayne County,
Michigan.

My commission expires December 21, 1919.

State of Michigan,
County of Wayne—ss.

On this 21st day of July A. D. 1916, before me, a Notary Public in and for said County, personally appeared E. P. Hammond, Edward Bleil, and M. C. DeWitt, known to me to be the persons named in, and who executed the foregoing instrument, and severally acknowledged that they executed the same freely and for the intents and purposes therein mentioned.

George H. Klein, Notary Public, Wayne County,
Michigan.

My commission expires August 28, 1917.

State of Michigan,
County of Wayne—ss.

On this 21st day of July A. D. 1916, before me, a Notary Public in and for said County, personally appeared M. L. Pulcher, William D. Rockwell, and Bert Morley, known to me to be the persons named in, and who executed the foregoing instrument, and severally acknowl-

edged that they executed the same freely and for the intents and purposes therein mentioned.

Lillian F. Archer, Notary Public, Wayne County,
Michigan.

My commission expires November 15, 1918.

Recorded July 26, 1916.
(10 fol.) (S & C)

[fol. 39] Certificate of Amendment
 to the
 Articles of Association
 of
 Detroit Automobile Club

(Postoffice Address 139 Bagley Ave.,
Detroit, Michigan.)

We, the undersigned, being the President and the Secretary of the Detroit Automobile Club, a corporation existing under the provision of Act No. 84 of the Public Acts of 1921 and amendments thereto, do hereby certify as required by Section 9, Chapter 1, Part 2 of said Act that at a meeting of the membership of said corporation expressly called for the purpose of amending its Articles of Association and held at the office of said corporation on the 17th day of April, A. D. 1931, it was resolved by a majority vote of the members present at said meeting of said corporation that Article I of the Articles of Association be and the same is amended so as to read as follows, viz.:

“Article I. The name or title by which said corporation is to be known in law is ‘Automobile Club of Michigan.’ ”

In witness whereof we hereunto sign our names this 17th day of April, A. D. 1931.

Wm. G. Bryant,
President.

W. A. Brush,
Secretary.

Filed April 20, 1931.

[fol. 40]

Letter of Consent from
Automobile Club of Michigan

Detroit Automobile Club,
A Michigan Corporation,
Detroit, Michigan.

The undersigned corporation, Automobile Club of Michigan hereby consents to your adoption and use of the name "Automobile Club of Michigan" as the corporate name of your company.

Automobile Club of Michigan,
By Richard Harfst,
President.

and Howard T. Browne
Secretary.

Filed April 20, 1931.

(Non Profit Stock Corporation)

Articles of Incorporation Extending Corporate Term
of
Automobile Club of Michigan

These Articles of Incorporation are made, signed and acknowledged by the president and the secretary of Automobile Club of Michigan, a non-profit corporation organized under the laws of the State of Michigan, for the purpose of extending the corporate term of said corporation pursuant to the provisions of Section (60 or 61, as the case may be) of Act No. 327 of the Public Acts of Michigan of 1931, known as the Michigan General Corporation Act, as follows:

Article I

The name of this corporation is Automobile Club of Michigan.

Article II

The purpose or purposes of this corporation are as follows: To promote and foster the healthy growth of [fol. 41] the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances

and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First," as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign-boarding of public highways; and to cooperate in any work or movement which may tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general. In general, to carry on any business in connection therewith and incident thereto not forbidden by the laws of the State of Michigan and with all the powers conferred upon corporations by the laws of the State of Michigan.

Article III

Location of the corporation is Detroit, in the County of Wayne, State of Michigan.

Postoffice address of registered office in Michigan is 139 Bagley Ave., Detroit 26, Michigan.

Article IV

The total authorized capital stock is None.

(1) Preferred: None shs.; Common: None shs.; Par Value \$ (Membership only) and/or shs. of (2) Preferred: none; Common: None; without par value.

(3) The following is a description of each class of stock of the corporation with voting powers, preferences and rights and the qualifications, limitations or restrictions thereof:

The Automobile Club of Michigan is a non-profit corporation with a membership of approximately 245,000 who have delegated to the Board of Directors of fifteen all power and authority to carry on the business of the Corporation and to execute any and all contracts, agreements and documents necessary to carry on all the activities, services and business of the Corporation.

[fol. 42] This is covered by the By-Laws of the Club to which each and every member has subscribed.

The amount of paid-in capital of this corporation is \$ None.

Article V

The members and directors and the number of members is as follows:

Names	Business Address Detroit, Michigan	Number of Shares		
		Common	Preferred	Non-Par
J. Lee Barrett	1005 Stroh Bldg.	None	None	None
John A. Brown	228 W. Congress	"	"	"
Wm. A. Brush	611 Stroh Bldg.	"	"	"
Wm. G. Bryant	2176 Nat'l. Bk. Bldg.	"	"	"
Chas. T. Bush	149 E. Larned St.	"	"	"
Roy M. Hood	703 Basso Bldg.	"	"	"
Henry S. Hulbert	660 Woodward Ave.	"	"	"
Dr. James W. Inches	D. A. C.	"	"	"
Ralph Thomas	164 E. Larned St.	"	"	"
Chas. B. Van Dusen	2727 Second Ave.	"	"	"
James Vernor	239 Woodward Ave.	"	"	"
Jesse G. Vincent	1580 E. Grand Blvd.	"	"	"
Edward J. Weeks	6400 E. Davison	"	"	"
Charles L. Wilson	5255 Tillman Ave.	"	"	"
Clarence E. Otter	3975 Cass Ave.	"	"	"

The above are also Directors. See Article VI below.
They hold Power of Attorney and Proxy of all members.

Article VI

The names and addresses of the board of directors are as follows:

Same as listed in Article V above.

Article VII

The term of this corporation is fixed at 30 years from the 26th day of July, A. D. 1946.

[fol. 43]

Article VIII

In Witness Whereof the said president and secretary of said corporation, pursuant to appropriate proceedings of the shareholders, a copy of which, certified by the secretary and verified by his oath is appended hereto, have made, signed and acknowledged these Articles of Incorporation this 22nd day of January, A. D. 1946.

(s) John A. Brown,
President.

(s) Wm. A. Brush,
Secretary.

State of Michigan,
County of Wayne—ss.

On this 22nd day of January A. D., 1946, before me, a Notary Public in and for said County, personally appeared John A. Brown, President, and Wm. A. Brush, Secretary of Automobile Club of Michigan, the corporation mentioned in the foregoing instrument, to me known and known to me to be such officers of said corporation, and who executed the foregoing instrument and severally acknowledged that they executed the same freely and for the intents and purposes therein mentioned.

Cora M. Hagar, Notary Public, Wayne County, Michigan. My commission expires November 29, 1946.

(Note: The statute does not contemplate that articles extending corporate term shall be used as a vehicle for any amendment of the corporate structure except term of existence.)

Certified Copy of Proceedings of Members Meeting

(To be appended to the new articles)

I, Wm. A. Brush, secretary of Automobile Club of Michigan, the corporation named in the foregoing Articles of Incorporation, do hereby certify that the following is a [fol. 44] true copy of the proceedings of a special meeting of the members of said corporation duly called for the express purpose of considering and taking action upon continuance of the corporate existence of said corporation for such further term as is permitted by law, and duly held on the 22nd day of January, A. D. 1946: John A. Brown, President, presided.

Roll call disclosed that, out of a total of 245,000 members outstanding, 245,000 members were present in person or by proxy.

The following resolution was introduced by William G. Bryant, seconded by Charles T. Bush:

Whereas, the corporate existence of this corporation is about to expire on the 26th day of July, 1946; and

Whereas, the members deem it desirable and beneficial

to them that the corporate term of this corporation be continued and extended;

Now, therefore, be it and it hereby is resolved, and the members do hereby consent and direct, that the corporate existence of Automobile Club of Michigan shall be extended and continued for a further term of 30 years from and after the date of expiration of the present term.

Upon vote by ballot upon the foregoing resolution 245,000 members voted, Aye, and no members voted. Nay.

The holders of more than two-thirds of the members, having voted in favor of said resolution, the chair declared the same duly adopted.

Upon motion, duly seconded, the meeting adjourned.

(s) Wm. A. Brush,
Secretary.

Subscribed and sworn to before me this 22nd day of January, A. D. 1946.

Cora M. Hagar, Notary Public, Wayne County, Michigan. My commission expires November 29, 1946.

[fol. 45] (Note: The same form with appropriate changes in recitals to conform to the facts may be used for renewals voted after corporate existence has expired, in which case a four-fifths vote is required. See Sec. 61, also Constitution of 1908, Art. XII, Sec. 3.)

Form 5—12-11-35—9M

Exhibit 2 to Stipulation of Facts.

BY-LAWS OF THE AUTOMOBILE CLUB OF MICHIGAN Effective January 1, 1940

Article I

Name

As provided for in the certificate of incorporation, this organization shall be known as the Automobile Club of Michigan.

Article II

Club Seal

The corporate seal shall carry the words "Automobile Club of Michigan" thereon.

Article III

Objects

Section 1. The Automobile Club of Michigan shall be essentially a members' Club, supported by members' subscriptions and not carried on for profits. Its objects are fully set forth in paragraph two of the Articles of Incorporation, as follows:

"To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; [fol. 46] to interest automobile owners and drivers in the principles of 'Safety First' as applied to automobile traffic; to promote touring and to obtain and furnish touring information and obtain the necessary sign-boarding of public highways; and to cooperate in any work or movement which may tend to benefit the automobile driver; user, owner or manufacturer, and the automobile industry in general."

Article IV

Directors

Section 1. The control and management of the Club shall be vested in a Board of fifteen (15) Directors. Any member of the Club in good standing shall be eligible to the office of Director.

Section 2. At the annual meeting of the Board of Directors held in December 1938, five (5) Directors shall be elected by said Board for a term of three (3) years to take the place of the four (4) Directors whose terms shall expire on December 31, 1938, and to add one extra Director to serve

for three (3) years; at the annual meeting of the Board of Directors held in December, 1939, five (5) Directors shall be elected by said Board for a term of three (3) years to take the place of the seven (7) Directors whose terms shall expire on December 31, 1939; and at its annual meeting held in December, 1940, five (5) Directors shall be elected by said Board for a term of three (3) years to take the place of the five (5) Directors whose terms shall expire December 31, 1940; and thereafter at each annual meeting, the said Board of Directors shall elect Directors to take the place of those whose terms expire on December 31 of that year. Said Directors to be elected for a term of three (3) years and to hold office as hereinbefore provided.

In case a vacancy occurs through death, resignation, removal by the Board for cause or other reason, same shall be filled as hereinafter provided.

[fol. 47] Section 3. The Board of Directors shall have general charge, management, and control of the affairs, funds and property of the organization.

The Board of Directors shall authorize all contracts, purchases and payments as it shall deem necessary and proper.

It shall control all the expenses and charges of the organization and authorize the employment of such assistants and clerks as it shall deem expedient, and receive and redress complaints, provided the same be properly made to it in writing.

It shall make such rules as to the use of the organization premises as it may find expedient, from time to time.

It may employ a manager for the Club and may delegate to him such of the duties in connection with the management and conduct of affairs of the organization as it may deem advisable. The Manager shall, at the expense of the Club, be placed under a bond as the Directors shall decide.

Article V

Officers and Their Duties

Section 1. The officers of the Club shall consist of a Board of Directors of fifteen (15) members, from and by whom a President, a First, a Second and a Third Vice President, a Treasurer and a Secretary who shall also be officers of the

Club, shall be elected at the annual meeting of the Directors.

Section 2. The President, or in his absence, one of the Vice-Presidents in the order of their election, shall preside at all the meetings, and if the President and the Vice-Presidents shall all be absent, a Chairman shall be chosen by vote.

The President, or in his absence, one of the Vice-Presidents, shall with the Treasurer sign all written contracts and obligations of the Club as authorized by the Board of Directors and shall perform such other duties as the Directors may assign to him.

Section 3. The Treasurer shall collect all dues, shall keep the accounts of the Club in books belonging to it. He shall make disbursements upon orders approved in writing by the President or the Manager, as approved by the Board of Directors. He shall render a statement of the accounts of the Club to the Board of Directors whenever requested to do so. His accounts shall be audited by a certified public accountant annually, or oftener as the Board of Directors may decide.

He shall also make investments of the surplus funds of the Club, but before doing so must first obtain the approval of those delegated that authority by the Board of Directors or a Committee appointed by them for that purpose.

He shall also be a member of the Finance and Auditing Committee at all times.

Section 4. The Secretary shall keep a record of all meetings of the Club, and proceedings of the Board of Directors. He shall conduct the correspondence of the Club and give notice of all meetings to the members of the Club, and to the members of the Board of Directors. He shall notify persons elected to membership of their election, keep a correct list of members, and notify the Treasurer of the names of all persons elected.

Article VI

Meetings and Order of Business

Section 1. The Annual Meeting of the Club shall be held on the second Tuesday of November each year, unless for some cause it shall be adjourned to a later date, and all meetings of the organization shall be held in the City of Detroit,

and special meetings may be called by the Board of Directors, when they so desire, and shall be called by the Board of Directors, upon written request of two hundred (200) [fol. 49] members in good standing. Notice of the time and place of holding such meeting, addressed to the last known place of residence or business of the member, shall be sent either (A) by mail to each member in good standing and enclosed in an envelope properly addressed, stamped and mailed to each member at least ten (10) days prior thereto; or, (B) by publishing such notice in the Motor News, or that publication which is the official organ of the Automobile Club of Michigan, and by mailing a copy of such Motor News or other official publication as above described, (in which said notice be published) to each member at least ten (10) days prior to the holding of such special meeting. Twenty-five (25) active members shall constitute a quorum. The order of business shall be:

- (a) Reading the minutes of preceding meetings.
- (b) Report of the President.
- (c) Report of the Treasurer.
- (d) Report of the Secretary.
- (e) Reports of the General Committees.
- (f) Other business regularly before the meeting.

Section 2. Regular meetings of the Board of Directors shall be held on Tuesday of each week, unless otherwise ordered. Eight Directors shall constitute a quorum at any regular or special meeting. The order of business, except when otherwise determined by a vote of those present shall be:

- (a) Reading of the minutes of the previous meeting.
- (b) Reports of the officers.
- (c) Reports of the Committees.
- (d) Unfinished business.
- (e) New business.

[fol. 50] The annual meeting of the Board of Directors shall be held on the first Tuesday in December of each year. The order of business shall be:

- (a) Reading of minutes of preceding annual meeting.
- (b) Report of the President.

- (c) Report of the Treasurer.
- (d) Report of the Secretary.
- (e) Report of Standing Committees.
- (f) Report of Special Committees.
- (g) Election of Directors.
- (h) Election of Officers.
- (i) Other business regularly before the meeting.

Special meetings of the Board of Directors may be called on any date by the President, and shall be held on a request in writing signed by at least five members of the Board. At such meetings only such matters should be considered as are contained in the call. Notice of Special Meetings shall be mailed to each member of the Board of Directors at least five days in advance thereof.

Section 3. Meetings of Committees may be called by the Board of Directors, the Chairman of the Committee, or on request in writing of any three members of such a committee. Notice in writing of said meeting, setting forth the purpose for which it is called, shall be mailed to each member of said committee at least five days prior thereto, and only the business specified in said call shall be acted upon at said meetings.

The President and Manager shall be ex-officio members of all committees.

[fol. 51]

Article VII

Vacancies

Section 1. If a vacancy shall occur in any office, it shall be filled by the Board of Directors by a majority vote of those present at any regular or special meeting of the Board held subsequent to the meeting at which said vacancy shall be announced or decided upon. Provided, that all members of the Board of Directors shall have been notified at least one week in advance of such meeting, that action for appointment to fill such a vacancy shall be taken. The officer so appointed shall hold office during the unexpired time of the officer to whose term he succeeds.

Section 2. A vacancy within the meaning of the preceding section shall be deemed to have occurred in the offices of

President, Vice-Presidents, Secretary, Treasurer, or members of the Board of Directors, by resignation properly presented to the Board of Directors and accepted by them by a majority vote of the Directors at any regular or special meeting, or whenever such officer or officers shall have been absent from three consecutive regular meetings of the Board of Directors, but not until such officer shall have been given at least seven days' notice in writing that the Board of Directors intend, at a meeting to be held at a definite date named, to determine whether they shall declare a vacancy in said office, and then only if the Directors shall declare by vote that said officer could not show good cause for his absence, it being always understood that the Board of Directors has the power to excuse such absentee.

Section 3. All resignations shall be acted upon by the Board of Directors at any regular or special meeting.

Article VIII

Committees

Section 1. Immediately after the election of officers by the Board of Directors, or as soon, thereafter as may be [fol. 52] expedient, the newly elected President shall, with the approval of the Board of Directors, appoint the following standing committees, each of said committees shall consist of three or more members, including a Chairman.

Finance & Auditing

Laws & Ordinances

Membership

Publicity

Roads & City Planning

Safety & Traffic

Signs & Road Posting

Touring Information

Branches

National Affairs and International Relations

Emergency Road Service

Club Publications

New Club Services

Taxations

Section 2. Whenever any member of a committee shall neglect or fail in the performance of his duties as such, it shall be the duty of the President, with the approval of the Board of Directors, to declare his position vacant and appoint another in his place.

Section 3. Additional committees may be appointed by the President from time to time as may seem desirable or expedient, subject to the approval of the Board of Directors. Such special committee shall perform only the duties imposed upon them at the time of their appointment.

Article IX

Duties of Committees

Section 1. It shall be the duty of the Finance and Auditing Committee between November 1st and December 31st of each year to prepare a budget for the use and guidance of the officers and directors of the Club in handling its [fol. 53] activities, finances, etc., during the following year, which budget shall be presented for the approval of the Board of Directors at the first regular or special meeting of the Board after the first day of January of each year.

They shall also have charge and supervision of the annual audit and all special audits of the Club's books and the records of the several officers, chairmen of Committees, and employees; and a report of such audit as prepared by an expert accountant or auditor, shall be delivered to the Chairman of the Committee and by him presented to the Board of Directors for their approval as soon after the 1st of January in each year as convenient.

Section 2. It shall be the duty of the Committee on Laws and Ordinances to inquire into and inform the Board of Directors as far as possible, as to all laws and ordinances, whether proposed or actually in force in the State of Michigan, City of Detroit, or elsewhere affecting the owners and users of automobiles. It shall urge the passage of proper laws and ordinances under the direction of the Board of Directors, and originate and propose such laws and ordinances as may help in safeguarding the interests of members of be of benefit to the public.

Section 3. It shall be the duty of the Membership Com-

mittee to suggest and carry on plans, when approved by the Board of Directors, looking to an increase in membership and to secure the yearly renewal of members. It shall cooperate with the Board and management to bring about and maintain the largest possible membership. It shall pass on all applications for membership and may make such investigation as to the character and standing of a proposed applicant as it deems necessary or desirable, and further act in accordance with Section 3 of Article X.

Section 4. It shall be the duty of the Publicity Committee to handle the publicity of the Club and to see that all of its activities are presented in proper form to the press.

[fol. 54] Section 5. It shall be the duty of the Committee on Roads and City Planning to cooperate with the local, state and national officials having charge or direction of city planning, road, street, alley, drain and bridge problems, and to suggest changes in laws or methods as will best promote the broadest use of our transportation facilities; and to perform such other duties in connection with city planning, road improvement and maintenance as may be referred to it by the Board of Directors of the Club.

Section 6. It shall be the duty of the Safety and Traffic Committee to take an active part in the "Safety First" movement, both local and national; and to investigate and report to the Board of Directors of the Club on such needed laws, rules and regulations as will aid in safeguarding of lives and property.

Section 7. It shall be the duty of the Signs and Road Posting Committee to take up, from a practical business standpoint, questions concerning systems of working and sign-boarding the streets of Detroit, and the roads of Wayne County and the State of Michigan, and to investigate and recommend such activities and laws to the Board of Directors as will best serve the safety and convenience of motorists.

Section 8. It shall be the duty of the Committee on Touring Information to supervise and assist the Touring Bureau of the Club in securing and disseminating reliable touring information and data.

Section 9. It shall be the duty of the Committee on Branches, of which Committee the Manager of the Auto-

mobile Club of Michigan may be the Chairman to suggest, supervise and carry on the establishment of Branches of this organization in such cities in Michigan as it shall deem wise; it shall recommend in writing the establishment of such branches as it considers advisable to the Board of Directors, who may authorize the establishment and maintenance of such Branches by two-thirds vote of all Directors. [fol. 55] Section 10. It shall be the duty of the Committee on National Affairs and International Relations to look after all relations of the Club with National Headquarters of the American Automobile Association, National legislation, and International contacts with legislation and foreign Clubs.

Section 11. It shall be the duty of the Committee on Emergency Road Service to supervise, assist and counsel the management of the Club in an effort to economically furnish the membership with the most efficient and satisfactory Emergency Road Service possible.

Section 12. It shall be the duty of the Committee on Club publications to consider and pass upon all matters involving the publication, issue and distribution of the Club paper or magazine to the end that the most satisfactory contact between Club headquarters and the membership is secured.

Article X

Membership

Section 1. The Honorary Membership shall be limited to twenty-five and may include ex-officio, the following: The President of the United States, the Governor of Michigan, and the Mayor of the City of Detroit. The Board of Directors by unanimous consent may elect as Honorary members any persons distinguished for their political, scientific, literary, industrial or administrative capacities. Honorary members shall be exempt from all fees, dues or subscriptions, but shall have no right to vote at any meeting of the Club, nor any right, title or interest in its property or assets.

Section 2. Life membership is secured by an active member commuting all his subsequent annual dues and future assessments by the payment at one time of two hundred and fifty dollars (\$250.00) upon making which

payment he shall become a life member of the Club and be exempt from the payment of all future dues and assessments. A life member shall continue to have all the rights [fol. 56] of an active member, it being understood that this organization has no power to extend life memberships in its national affiliations.

Section 3. Any person, male or female, of good moral character, over sixteen years of age is eligible to active membership in the Club: provided, however, that when any application is filed by a person other than a white person, it shall be referred through the Chairman of the Membership Committee and the Manager of the Club directly to the Board of Directors, who shall have authority to receive or reject the application. Application for membership must be made in writing on a special blank, provided for that purpose. The application must state the name, address and occupation of the person proposed, and be endorsed by a member of the Club. The membership committee of the Club may make such investigations as to character and standing of the proposed applicant as it deems necessary or desirable, and if in their judgment no objection exists may declare the applicant elected to membership. If any objection is raised in the membership committee, the application shall be reported at the next regular or special meeting to the Board of Directors who shall take a vote by ballot. Two negative votes in the Board of Directors shall prevent the election of the applicant.

Section 4. No person shall have the benefits of the organization until he shall have paid to the Treasurer the fees and dues hereinafter prescribed.

Section 5. Any member who is in good standing, not in arrears or indebted to the Club, against whom no charges are pending, may resign his membership by delivering a notice thereof to the Secretary, who shall report the same at the next meeting of the Board of Directors, and upon resigning, such a member shall forfeit all his rights and interests in the Club property and assets.

Section 6. Every application for membership shall be in such form as the Board of Directors may from time to time approve.

[fol. 57]

Article XI

Entrance Fees and Dues

Section 1. There shall be no entrance fees. The dues shall be as follows: For active membership, annual dues amounting to ten dollars (\$10.00); which must accompany application.

Upon payment of the first annual dues, each member shall be provided with, free of charge, one radiator emblem upon the condition that *that* he shall return same upon ceasing to be a member of the Club.

Annual dues shall be due and payable on the first day of the month in each year, corresponding to the month in which the member was originally admitted to membership, at which date notices shall be sent by mail by the Club Treasurer. Applicants becoming members after the fifteenth of the month shall have a membership card dated the first of the month in which said application is filed.

Section 2. Any member whose annual dues remain unpaid for thirty days after receiving notice from the Club Treasurer that they are due, shall stand suspended from all privileges of the Club. He then shall be notified by the Treasurer of his suspension, and if shall fail to pay such dues within thirty days after such notification of suspension, he shall cease to be a member of the Club; but he shall not thereby be released from the payment of said dues, and shall be held for the payment of two months' dues and the expense of collecting the same.

Article XII

Discipline

Section 1. Any member may be admonished, suspended or expelled by the Board of Directors for conduct injurious to the welfare or character of the organization, or for the willful or reckless disregard of the existing laws or ordinances [fol. 58] of the State or municipal divisions thereof; provided that before any such action shall be taken, the member against whom complaint has been made shall be given ten days' notice in writing of the charge against him, and have an opportunity to make a defense before the Board of Directors.

Article XIII

Notices

Section 1. All notices required to be sent to each member shall be sent by mail to each member's residence or place of business (either in the form of special notice or as published in the Motor News) as the same may appear on the Secretary's books and such mailing shall be deemed presumptive evidence of the services of such notices.

Article XIV

Amendments

Section 1. The Board of Directors shall have power to make, amend or repeal the by-laws of this organization by a vote of two-thirds of all the Directors, at any regular or special meeting of the Board, provided that notice of intention to make, amend, or repeal the by-laws, in whole or in part, shall have been given to each Director at least ten (10) days prior to the meeting; or without any such notice, by a vote of all fifteen members of the Board of Directors.
Correct to

January 1, 1940

[fol. 59] Amendments to By-Laws of Automobile
Club of Michigan for the Period

January 1, 1940, to March 15, 1947

January 28, 1941.

Add Section 2 to Article III, to read:

This corporation shall use its funds only to accomplish the objects and purposes specified in Section 1 of this Article. And no part of said funds shall inure, or be distributed, to the members of this corporation. On dissolution, the funds of the corporation shall be distributed to one or more regularly organized, non-profit organizations devoted to one or more of the objects and purposes of this corporation, or to one or more regularly organized educational or

charitable organizations to be selected by the Board of Directors.

April 7, 1942.

Add paragraph 3 to Article IX, Section 1, to read:

They shall prepare for the Annual Meeting of the Board of Directors or at any other time directed by the Board, or as the Committee may deem necessary, a schedule of the holdings in securities (and cash available for investment), held by the Club together with their recommendations for the sale and/or transfer thereof, and for the purchase of additional securities. Such purchases, sales, and transfers as are authorized and approved by the Board of Directors shall be made by the Treasurer. If, however, it should come to the attention of the Treasurer and/or the Finance Committee that because of market conditions certain sales, transfers or purchases of securities are advisable prior to a meeting of the Board of Directors such transactions may be made by the Treasurer upon the written authority and approval of a majority of the Directors.

[fol. 60] April 7, 1942.

Change Section 3 of Article V to read:

The Treasurer shall have custody of the funds of the Club, collect all dues and accounts receivable, and shall keep the accounts of the Club in the books belonging to it. He shall make disbursements only upon orders authorized and approved by the Board of Directors except in case the disbursement shall be in an amount not in excess of Five Hundred Dollars (\$500.00), in which case approval by the President or General Manager of the Club shall be sufficient. He shall render a statement of the accounts of the Club to the Board of Directors at least once in each year and at such other times as the Board may require him to do so. His accounts shall be audited by a Certified Public Accountant annually, or oftener as the Board of Directors may decide.

He shall have the authority to invest and reinvest all the surplus funds of the Club which are on deposit in the "INVESTMENT ACCOUNT," but before making any invest-

ments he shall first obtain the authority and approval of the Board of Directors.

As such Treasurer, he shall also be a member of the Finance and Auditing Committee.

February 15, 1944.

Add at end of Section 1, Article III the words "PUBLIC RELATIONS."

[fol. 61] **Exhibit 3 to Stipulation of Facts**

May 16, 1934

IT:E:RR
CQ

Automobile Club of Michigan
139 Bagley Avenue
Detroit, Michigan

Sirs:

Reference is made to your claim for exemption from payment of the capital stock tax imposed by section 215 of the National Industrial Recovery Act.

In order to determine whether you are entitled to such exemption, the Bureau must first determine whether you are entitled to exemption from Federal income taxation under the provisions of section 103 of the Revenue Act of 1932. You are, therefore, requested to furnish the following information in the form of an affidavit sworn to by one of your principal officers:

1. Date of incorporation, if you have been incorporated, or if not, the date of organization.
2. Detailed explanation of your actual activities.
3. Sources from which your income is derived:
 - (a) From members.
 - (b) From nonmembers.
 - (c) From all other sources.
4. The disposition made of such income.
5. Whether you pay interest or dividends on capital stock, if any, and, if so, the rate paid.

6. Whether any income is credited to surplus or may inure to the benefit of any private shareholder or individual. [fol. 62] 7. All other facts relating to your activities which may affect your status.

Your affidavit should be accompanied with copies of your articles of incorporation and by-laws, and a financial statement for the year 1933 showing assets and liabilities and a classified list of receipts and disbursements.

The information indicated above should be furnished at the earliest practicable date. In your reply reference should be made to IT:E:RR-CQ.

Respectfully,

Chas. T. Russell,
Deputy Commissioner,

By

Chief of Section.

CQ/VC-1

Exhibit 4 to Stipulation of Facts

AUTOMOBILE CLUB OF MICHIGAN

Telephone Cherry 2911

139 Bagley Avenue

Detroit, Michigan

May 24, 1934

Commissioner of Internal Revenue,
Treasury Department,
Washington, D. C.

Re: IT: E: RR

CQ

Attention Mr. Chas. T. Russell

Dear Sir:

Answering your letter of May 16th referring to exemption from payment of capital stock imposed by section 215 of the National Industrial Recovery Act.

[fol. 63] (1) Date of incorporation of Detroit Automobile Club, July 21, 1916: name changed to Automobile Club of Michigan, July 24, 1930.

(2) Dues of the Automobile Club of Michigan are \$10.00 per year to all members without exception. No entrance or initiation fee. Club's activities are composed of touring service, such as logs, road maps, general touring information to members; emergency road service such as starting of members' disabled cars on the road, towing cars to official club garages, changing tires, etc.; the Michigan Motor News, a monthly magazine published by the Club for members only; and we are also interested in safety activities and several men are employed by the Club for work in the public schools as well as work in cooperation with the various cities of the state to promote safety and improve traffic conditions. We cooperate in any work or improvement which may tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

(3) Our source of income is from membership dues, the sale of advertising in Michigan Motor News, and interests on funds invested. (See financial statement attached.)

(4) See financial statement attached showing detailed account of expense and income.

(5) We do not pay interest or dividends on capital stock—in fact the Club has no capital stock. Dues of all members is the same—\$10.00 per year.

(6) The attached financial statement will show the disposition of any excess of income over disbursements, and as above stated no income is credited to the benefit of any preferred shareholder or individual.

(7) The Automobile Club of Michigan is strictly a non-profit organization. No director has ever received remuneration of any kind for his services. It is not only a service [fol. 64] corporation for its members, but a civic corporation as well, and has always been so considered.

Very truly yours, "

J. C. Sasser
Assistant Treasurer

State of Michigan,
County of Wayne—ss.

Before me, a Notary Public in and for the County of Wayne, State of Michigan, appeared J. C. Sasser, who states that the above statement is true and correct, and

that he is the Assistant Treasurer of the Automobile Club, of Michigan.

Allan G. Dingwall, Notary Public, Wayne Co. Michigan. My commission expires Oct. 14, 1936.

[fol. 65]

BALANCE SHEET
AUTOMOBILE CLUB OF MICHIGAN
APRIL 1934

ASSETS

CURRENT ASSETS:

Cash in offices	1,240.00	
Cash on hand and in banks—		
National Bank of Detroit	82,298.64	
Detroit Savings Bank	7,175.01	
Mfgs. National Bank	79,052.91	
Certificates of Deposit	8,072.04	
Bonds	194,229.72	
Accts. Rec. M.M.Ns. 2,344.30		
Less reserve for bad debts	457.93	1,886.37
Accts. Rec. D.A.I.I.	1,635.71	
Accts. Rec. Misc.	13,389.15	

Total Current Assets 388,979.55

OTHER ASSETS:

Deposits in closed bank & trust companies 46,270.10

PROPERTY ACCOUNT:

Furniture & Fixtures—Detroit	43,725.44	
Divisions	23,063.91	
Automobiles	3,421.99	
	70,211.34	
Less reserve for depreciation	39,732.36	30,478.98

UNAMORTIZED PORTION OF LEASE—

HOLD IMPR. 46,014.85

DEFERRED CHARGES:

Inventories	10,116.84	
Miscellaneous	15,656.93	25,773.77

TOTAL ASSETS 537,517.25

[fol. 66]

LIABILITIES

ACCOUNTS PAYABLE:

Detroit Purchase Expense	24,243.91	
Miscellaneous	5,250.54	
Investment fluctuation & general contingency fund	50,000.00	

Total Current Liabilities 79,494.45

DEFERRED INCOME 196,846.13

OPERATING FUND: 271,349.34

INCOME IN EXCESS OF EXP.
FOR 4 MTHS. PERIOD END-
ING APRIL 30, 1934. (10,172.67) 261,176.67

TOTAL LIABILITIES & RESERVES 537,517.25

Exhibit 5 to Stipulation of Facts

June 11, 1934.

IT:E:RR

CQ

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

Sirs:

Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation.

The evidence submitted discloses that the Detroit Automobile Club was incorporated under the laws of the State of Michigan in 1916 and that the name of the organization was changed to the Automobile Club of Michigan in 1931. You were formed "to promote and foster the healthy growth of the automobile industry; to secure the adoption and endorsement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for [fol. 67] traffic; to interest au-omobile owners and drivers in the principles of 'Safety First' as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign boarding of public highways; and to co-operate in any work or movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general."

Your assistant treasurer in an affidavit states that your activities consist of a touring service, such as logs, road maps, general touring information to members; emergency road service such as starting of members' disabled cars on the road, towing cars to official club garages, changing tires, etc.; the publication of the Michigan Motor News, a monthly magazine published for your members only; and the employment of several men to work in public schools in cooperation with various cities of the state to promote safety and to improve traffic conditions. It is stated that you cooperate in any work or improvement or manufacturer, and the automobile industry in general;

which tends to benefit the automobile driver, user, owner, that your income is derived from membership dues, sale of advertising in your publication, and interest on funds; that you do not pay interest or dividends; and that you have no capital stock. Your financial statement discloses that your income is used to defray executive, legal, touring, emergency road service, safety and traffic signs, and miscellaneous operating expenses.

Based on the foregoing, it is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business.

[fol. 68] Any changes in your form of organization or method of operation, as shown by the evidence submitted, must be immediately reported by you to the collector of internal revenue for your district, in order that the effect of such changes upon your present exempt status may be determined.

The exemption granted in this letter does not apply to taxes levied under other titles or provisions of the respective revenue acts, except in so far as exemption is granted expressly under those provisions to organizations enumerated in section 103 of the Revenue Act of 1932.

A copy of this letter is being transmitted to the collector of internal revenue for your district.

By direction of the Commissioner.

Respectfully,

(Signed) Chas. T. Russell.
Deputy Commissioner.

CQ/OEL-1

[fol. 69] **Exhibit 6 to Stipulation of Facts**
(16)

TREASURY DEPARTMENT
Internal Revenue Service
Sept., 1937

September 29, 1937

QUESTIONNAIRE
FOR CLUBS ORGANIZED AND OPERATED EX-
CLUSIVELY FOR PLEASURE, IT:RR REC-
REATION, AND OTHER NONPROFIT-
ABLE PURPOSES, ETC.

Claiming Exemption Under Section 101(9) of the Revenue Act of 1936

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

If the name and address at the left hereof is not the present name and address please indicate present name and address in appropriate space in affidavit below.

State of Michigan,
County of Wayne—ss.

Albert R. Thomson deposes and says that he is the Treasurer of the Automobile Club of Michigan, located at 139 Bagley Ave., Detroit, Michigan, and that the following answers and statements and attached financial statements showing the assets and liabilities of the organization and a classified list of the receipts and disbursements during the accounting period indicated are true to the best of his knowledge and belief:

1. Have your articles of incorporation or association or by-laws been changed or amended since copies thereof were last submitted to the Bureau? Yes—See certified copy of minutes of 6/15/37 attached.

If so, submit copies of such changes or amendments.
[fol. 70] 2. Have you disposed of any of your real prop-

erty since you were held to be exempt? No. If so, the year or years in which sold, the cost of the property, selling price and the terms of sale should be clearly stated.....

3. Have you rented any of your property since you were held to be exempt? No. If so, the year or years in which rented, the purposes for which rented and the amount received should be shown.....

4. Since you were held to be exempt, has your club been supported entirely by membership fees, dues and assessments? Yes.

If not state full particulars.....

5. Attach financial statements showing the assets and liabilities of the organization as at the close of the latest accounting period (ended Jan. 1, 1937) and a classified list of the receipts and disbursements during the same accounting period.

Albert R. Thomson (Signature of a principal officer)
Treasurer.

Subscribed and sworn to before me this 26th day of October, 1937.

Allan G. Dingwall (Signature of officer administering oath) Notary Public, Wayne Co., Mich. My Com. Exp. Oct. 1, 1940.

Attach:

Financial statements.

[fol. 71]

Automobile Club of Michigan
Telephone Cherry 2911
139 Bagley Avenue
Detroit, Michigan

October 27, 1937

Mr. Chas. T. Russell, Deputy,
Commissioner of Internal Revenue,
Treasury Department,
Washington, D. C.

File—IT:RR

Dear Mr. Russell:

Replying to your letter of September 29th with which you enclosed questionnaire for clubs organized and oper-

ated exclusively for pleasure, recreation, and other non-profitable purposes, etc.—we enclose herewith the questionnaire completely filled out and signed by our Treasurer, Albert R. Thomson. We also enclose a copy of our financial statement as of January 1, 1937—together with certified copy of minutes of our Board of Directors showing change in our by-laws since copies were last submitted to the Bureau.

In this connection, our Grand Rapids office has forwarded to us your letter of October 13th addressed to the Grand Rapids Automobile Club, Grand Rapids, Michigan. While there is no organization known as the Grand Rapids Automobile Club, we feel quite sure that the questionnaire enclosed with your letter was intended for our Grand Rapids office. We wish to explain that we have offices in twenty-six Michigan towns outside of the City of Detroit. All income and expense at those offices clears thru the main office in Detroit. In other words, they are not separate automobile clubs but all a part of the Automobile Club of Michigan which is one concern. We have in-[fol. 72] structed our various branch offices to forward to us any such questionnaires which they might receive from the Treasury Department.

Very truly yours,

J. C. Sasser
Assistant Treasurer

EW

[fol. 73]

**Financial Statement
Automobile Club of Michigan**

December—1936

Ex. B (1)

**Income & Expenses
December, 1936**

Cash Income

	Dec. 1936	Nov. 1936	Dec. 1935
Detroit Memberships—New	17,297.83	14,610.84	8,154.84
Renews	18,746.36	16,147.84	13,592.99
Sales, Maps & Guides	22.95	35.75	39.80
Interest Earned	1,288.73	1,444.40	17.34
Misc. Income	36.44	58.38	561.12
Total Income—Detroit	37,392.31	32,197.21	21,943.85
Motor News	9,391.61	12,720.66	6,754.56
Divisions	31,528.54	25,159.49	19,587.02
Total Income—All Sources	78,312.46	70,077.36	48,285.43

Cash Expenses

Executive:			
Salaries	2,350.00	2,612.50	2,725.00
Printing & Stationery	90.51	17.73	4.01
Telephone & Telegraph	35.11	64.13	34.66
Traveling	61.75	3.80	254.94
Auto Expenses	4.93	47.83	100.45
Dues & Memberships		10.00	
Director's Meetings	33.30	55.97	21.18
Entertainment	62.89	77.00	
Miscellaneous	67.54	94.01	11.14
	2,706.03	2,982.97	3,151.38
Legal:			
Salaries	785.00	797.50	640.00
Printing & Stationery			25.85
Telephone & Telegraph	47.32	48.94	39.69
Traveling	57.71	21.75	43.35
Court Costs	3.85	6.20	
Miscellaneous	40.00		7.88
Rent	175.00	175.00	
	1,108.88	1,049.39	756.75

[fol. 74]

Touring:			
Salaries	2,560.00	2,470.00	2,230.00
Printing & Stationery	241.66	94.38	290.05
Telephone & Telegraph	133.55	61.62	35.56
Traveling	22.54	236.88	
Auto Expense	42.12	252.58	29.10
Maps & Guides	147.80	1,101.88	109.98
License Expense	23.85	7.82	9.92
Drafting	13.47	9.42	
Miscellaneous	18.15	7.75	25.76
	3,203.14	4,242.33	2,510.40

Ex. B (2)

Emergency Road Service:

Salaries.....	1,925.00	1,925.00	1,630.00
Printing & Stationery.....	179.29	329.36	3.65
Telephone & Telegraph.....	113.56	111.29	95.26
Traveling.....		7.00	
Auto Allowance.....	114.65	146.42	155.36
Garage Service.....	6,210.07	5,121.88	5,143.28
Miscellaneous.....	1.03		
	8,643.60	7,640.95	7,020.25

Safety & Traffic:

Salaries.....	996.81	926.16	735.00
Printing & Stationery.....	676.90	273.11	317.21
Telephone & Telegraph.....	11.26	11.24	10.52
Traveling.....	399.69	377.77	217.77
Ponchos Hats Armbands, Prizes, Exp. chg.....	1,012.51	665.78	5.67
Rent.....			31.12
Dinners & Banquets.....	64.44	103.71	114.45
Miscellaneous.....	.75	21.79	24.82
Postage.....	114.74	130.39	140.09
	3,277.10	2,509.95	1,596.65

Signs:

Salaries.....	175.00	175.00	175.00
Street & Road Signs.....	40.73	384.89	115.97
	134.27	569.89	290.97

Membership Selling:

Salaries.....	210.00	207.50	165.00
Printing & Stationery.....	361.67	655.91	598.57
Telephone & Telegraph.....	615.98	605.95	516.74
Commissions.....	5,237.50	4,029.00	2,329.00
New Car Reports.....	45.50	45.50	41.50
Welcome Service New Members.....	6.00	26.00	
Miscellaneous.....			11.75
	6,476.65	5,569.86	3,662.56

[fol. 75]

Accounting:

Salaries.....	2,447.30	2,477.85	2,274.44
Printing & Stationery.....	334.46	110.23	402.21
Telephone & Telegraph.....	18.93	18.55	15.88
Auditing.....	100.00	100.00	110.00
Addressograph Rep.....	84.27	202.92	65.57
Miscellaneous.....	6.45		35
	2,991.41	2,909.55	2,868.45

General:

Salaries.....	395.00	381.00	370.00
Printing & Stationery.....	849.26	466.78	207.66
Federal Tax on Payroll.....	59.54	263.56	
Insurance.....	355.41	358.21	198.27
Emblems.....	159.00	897.21	365.14
A. A. A. Dues.....	1,892.75	1,519.50	1,147.25
Miscellaneous.....	213.43	122.96	26.72
Entertaining.....	672.33	10.50	367.68
Gifts & Donations.....	228.39		600.58

General (Continued)		Ex. B (3)	
Prizes for suggestions.....	15.00		
Dept. Head Meetings.....	26.88		30.31
Postage & Mail Expense.....	1,320.83	1,218.38	781.54
Depreciation.....	436.97	410.51	525.06
Legal Expense.....			35.00
House Organ.....	17.00	15.30	
Grosse Pointe office expense.....	459.76	484.51	81.55
Trust Account Service.....		187.50	
	6,783.55	6,336.12	4,736.76
Special Representative:			
Salaries.....	110.00	110.00	100.00
Expenses.....	14.25	12.12	11.23
	124.25	122.12	111.23
Special Appropriations:			
Shows.....		747.29	
Publicity.....	377.70	398.69	298.39
Sound Car Expense.....	92.56	147.08	158.92
A. A. A. Entertainment.....	751.58	2,372.94	
Advertising.....	59.50	77.12	174.61
Radio Broadcast.....	1,137.50	1,137.50	2,187.50
Highway Survey Expense.....			669.68
	2,419.14	4,880.62	3,489.08
[fol. 76]			
Accident Insurance Policies:			
Salary.....	382.70	307.70	211.90
Printing & Stationery.....	2.69	5.47	40.55
Policy Premiums.....	2,264.56	1,585.98	686.42
	2,649.95	1,899.15	938.87
Building:			
Salaries.....	942.65	874.96	706.21
Janitor Supplies.....	337.34	466.24	212.81
Heat.....	339.63	251.23	265.42
Elec. Current on Building.....	325.20	587.34	256.09
Elec. Current on Signs.....	42.00	42.00	102.00
Taxes.....	520.56	517.54	527.45
General Repairs.....	376.69	1,082.69	104.02
Rent.....	2,750.00	2,750.00	3,166.66
Insurance.....	74.04	72.41	58.63
Water Tax.....		31.75	
Amortization of Leasehold Imp.....	1,631.95	1,631.92	1,631.92
	7,340.06	8,308.08	7,031.21
Less amt. charged to D. A. I. I.....	4,382.00	4,382.00	4,382.00
	2,958.06	3,926.08	2,649.21
Detroit Expenses.....	43,376.03	44,628.98	33,782.56
Less general overhead chg. to Divisions.....	5,601.96	5,267.40	2,502.64
	37,774.07	39,361.58	31,279.92
Total Expense—Detroit.....	37,774.07	39,361.58	31,279.92
Motor News.....	7,966.29	14,648.31	6,767.35
Divisions.....	19,973.24	26,018.80	10,541.15
	65,713.60	80,028.69	48,628.42
Total Expenses—All Sources.....	65,713.60	80,028.69	48,628.42
Net Income or Deficit.....	12,598.86	9,951.33	242.99

[fol. 77]

Income and Expenses
Divisions

Ex. C (1)

December, 1936

		Dec. 1936	Nov. 1936	Dec. 1935
ADRIAN	Income Expenses	1,227.00	882.00	759.25
		935.00	1,030.31	729.35
		292.00	148.31	29.90
ALBION	Income Expenses	211.00	152.84	81.00
		265.78	216.52	308.38
		54.78	63.68	227.38
ANN ARBOR	Income Expenses	1,364.00	1,201.00	1,110.72
		1,309.24	1,478.74	1,257.30
		54.76	277.74	146.58
BATTLE CREEK	Income Expenses	1,565.00	1,385.74	1,118.73
		1,411.03	1,608.03	1,183.61
		153.97	222.29	64.88
BENTON HARBOR	Income Expenses	675.91	615.74	664.11
		460.67	585.96	447.48
		215.24	29.78	216.73
COLDWATER	Income Expenses	441.00	270.00	261.00
		586.61	420.81	303.76
		145.61	150.81	42.76
DEARBORN	Income Expenses	1,145.21	1,076.70	726.00
		722.46	715.38	572.24
		422.75	361.32	163.76
GRAND RAPIDS	Income Expenses	2,560.35	2,109.25	1,799.25
		2,242.85	1,995.16	1,397.87
		317.50	114.09	401.38
JACKSON	Income Expenses	1,190.50	1,133.00	921.50
		997.06	1,218.94	921.90
		193.44	85.94	40
KALAMAZOO	Income Expenses	1,462.99	1,413.83	1,126.27
		1,309.47	1,506.85	1,060.39
		153.52	93.09	65.88
LANSING	Income Expenses	2,893.31	1,686.13	1,633.50
		2,006.27	1,818.85	1,591.89
		887.04	132.72	41.61
MONROE	Income Expenses	1,550.20	1,070.50	796.03
		1,122.73	974.48	744.79
		427.47	96.02	51.24

[fol. 78]

[fol. 79]

Income & Expenses
Motor NewsEx. D
Monthly

December, 1936

Income

	Dec. 1936	Nov. 1936	Dec. 1935
Subscriptions.....	7,509.65	6,202.00	4,580.00
Advertising Revenue.....	1,715.30	6,352.00	1,972.00
Miscellaneous.....	166.66	166.66	166.66
Syndicate Articles.....			35.90
Total Income.....	9,391.61	12,720.66	6,754.56

Expenses

Salaries.....	600.00	573.75	555.00
Printing & Stationery.....	5,004.91	10,504.32	4,053.06
Telephone & Telegraph.....	32.01	39.06	22.80
Traveling.....	313.43	17.85	28.72
Commissions.....	380.25	1,440.50	419.25
Mailing.....	536.50	863.00	331.00
Editorials.....	193.50	75.00	50.00
Cuts.....	457.25	888.18	423.91
Miscellaneous.....	83.42	23.65	99.78
Arts.....	4.84	53.72	51.35
Agency Discount.....	564.79	169.28	813.32
Bad Accounts.....			59.16
Photos.....	3.00		
Bad Accounts.....	191.70		
Total Expenses.....	7,966.29	14,648.31	6,707.35
Income or Deficit.....	1,425.32	1,927.65	47.21

[fol. 80]

Condensed Statement
Motor News

Ex. D (2)

For 12 Months Period—Jan. 1, 1936 to Dec. 31, 1936

Income

	Actual	Budget	Increase Decrease	Actual performance per cent of Budget
Subscriptions.....	83,956.90	70,000.00	13,956.90	119.3
Advertising Revenue.....	36,673.51	35,000.00	673.51	101.9
Miscellaneous.....	2,078.72	2,000.00	78.72	103.9
Total Income.....	121,709.13	107,000.00	14,709.13	113.7

Expenses

Salaries.....	6,966.25	6,980.00	6.25	100.
Printing & Stationery.....	64,728.13	59,000.00	5,728.13	109.7
Telephone & Telegraph.....	339.17	350.00	10.83	96.9
Traveling.....	998.88	750.00	248.88	133.2
Commissions.....	7,712.50	8,000.00	287.50	96.4
Mailing.....	6,082.94	5,000.00	1,082.94	121.7
Editorials.....	1,188.00	575.00	611.00	206.3
Miscellaneous.....	683.65	350.00	333.65	195.3
Arts.....	255.53	250.00	5.53	102.2
Agency Discount.....	3,014.66	3,000.00	14.66	100.5
Bad Accounts.....		1,000.00	1,000.00	
Photos.....	168.95	100.00	68.95	169.
Total Expenses.....	96,462.74	88,735.00	7,727.74	108.7
Income or Deficit.....	25,246.39	18,265.00	6,981.39	139.2

[fol. 81]

Condensed Statement
Income & Expenses

Ex. E (2)

For 12 Months Period—Jan. 1 thru Dec. 31, 1936

Income

	Actual	Budget	Increase Decrease	Actual performance per cent of Budget
Memberships—Detroit . . .	468,941.15	394,500.00	74,441.15	118.9
Divisions . . .	371,539.63	305,500.00	66,039.63	121.6
Sales of Maps & Guides . . .	366.77		566.77	
Int. Earned & Misc.	13,516.87	8,800.00	4,716.87	153.6
Motor News Adv. & Misc. . .	37,752.23	37,000.00	752.23	102.
Total Income	892,318.65	745,800.00	146,518.65	119.6

Expenses

Executive	36,328.15	37,710.00	1,381.85	98.3
Legal	11,528.92	9,310.00	2,218.92	123.8
Touring	59,703.71	45,015.00	14,688.71	132.6
Emer. Road Service	89,452.46	66,585.00	22,867.46	134.3
Safety & Traffic	24,418.32	21,635.00	2,783.32	112.9
Signs	4,344.82	5,100.00	755.18	85.2
Membership Selling	65,051.79	48,900.00	17,161.79	135.1
Accounting	35,740.83	33,825.00	1,915.83	105.7
General	75,530.74	62,850.00	12,880.74	120.6
Spec. Representative	1,448.21	1,650.00	201.79	87.9
Spec. Appropriations	29,802.78	16,350.00	13,452.78	182.3
Accident Policy	18,916.17	14,825.00	4,091.17	127.8
Bldg. Rent & Maintenance .	34,999.57	32,050.00	2,949.57	109.2
Total Expenses	488,266.47	395,605.00	92,661.47	122.
Less overhead chg. to Divisions	58,792.42	32,000.00	26,792.42	183.7
Total Exp. Detroit	429,474.05	353,605.00	65,869.05	118.1
Motor News	96,462.74	88,735.00	7,727.74	108.7
Divisions	276,516.82	200,000.00	76,516.82	138.3
Total Exp. All Sources . . .	802,453.61	652,340.00	150,113.61	123.
Net Income or Deficit	89,863.04	93,460.00	3,596.96	96.2

Note: The item of Membership represents the total received from that source without setting aside \$1 per membership for subscriptions to Motor News

[fol. 82] **EXHIBIT 7 TO STIPULATION OF FACTS**

July 5, 1938

IT:RR:MM

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

Sirs:

Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.

Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936.

By direction of the Commissioner.

Respectfully, (Signed) John R. Kirk, Deputy Commissioner.

MM/ij 1

[fol. 83] **Exhibit A to Stipulation of Facts**

May 12, 1945

IT:P:T-1

FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit, Michigan

Gentlemen:

Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103(9) of the Reve-

nue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto as set forth in G. C. M. 23688, C. B. 1943, 283.

It is therefore requested that you fill in all the information outlined on the enclosed Form 1025. Attention is called to the data requested in item 15. The classified statement of the receipts and expenditures referred to thereon should be submitted but it will not be necessary for you to furnish copies of your articles of incorporation and bylaws as copies thereof are on file in this office. However, if any changes have been made thereon, a copy of such amendments and the authorization therefor should be furnished.

The information requested in item 8 should cover all your actual activities during your last complete year of operation.

[fol. 84] The above information should be furnished the Bureau within thirty days from the date of this letter, marked for the attention of IT:P:T-1-FDF.

Very truly yours,

Norman D. Cann, Deputy Commissioner, By
(Signed) L. K. Sunderlin, Chief of Section

Enclosure:

Form 1025
FDFoley/em-3

5-5-45

Exhibit 8 to Stipulation of Facts**AUTOMOBILE CLUB OF MICHIGAN**

Telephone Cherry 2911

139 Bagley Avenue

Detroit 26, Michigan

June 11, 1945

Commissioner of Internal Revenue
Washington, D. C.

~~In~~ re: Automobile Club of Michigan
139 Bagley Avenue,
Detroit 26, Michigan

Symbols: IT:P:T-1:FDF

Sir:

Pursuant to request contained in your letter of May 12, 1945, there is enclosed herewith Form 1025—Exemption Affidavit.

[fol. 85] The form is completely filled out in accordance with your request, together with additional information which is attached.

Very truly yours,

J. C. Sasser

Assistant Treasurer

Encs.

Form 1025

Treasury Department
Internal Revenue Service

(Revised Feb. 1943)

EXEMPTION AFFIDAVIT

For Use of Organizations Claiming Exemption from Federal Income Tax as Social Clubs under Section 101(9) of the Internal Revenue Code and the Corresponding Provisions of Prior Revenue Acts.

(To be made only by a principal officer of the organization claiming exemption)

(Form 990 should be filed with this affidavit)

State of Michigan,
County of Wayne—ss.

John A. Brown deposes and says that he is the First Vice President of the Automobile Club of Michigan located at 139 Bagley Avenue, Detroit 26, Michigan and that the following answers and statements, including all statements attached hereto, are complete and true to the best of his knowledge and belief:

1. Is the organization incorporated? Yes. If so, under the laws of what State? Michigan. When? July 24, 1930. If not incorporated, state the manner of organization and the date thereof.....

[fol. 86] 2. Is the organization the outgrowth or continuation of any form of predecessor? Yes. If so, state the name of such predecessor and the period during which it was in existence—The Detroit Automobile Club. Incorporated July 21, 1916. Name changed to Automobile Club of Michigan on April 17, 1931.

3. Has the organization filed Federal income tax returns? No. If so, for what year or years?.....

4. State briefly the specific purposes for which the organization was formed. (Do not quote from, or make reference to, the articles of incorporation or bylaws for this purpose.) To provide a non profit corporation where members could secure automobile club services—such as touring information, emergency road service and state licenses of various kinds; to encourage touring over permanent highways; aiding in securing uniform motor laws and ordinances; keeping the members informed of

matters of interest through the Motor News and educating and training members in the principles of safety first in order to prevent highway accidents.

5. Is the organization authorized to issue capital stock? No. If so, state (1) the class or classes of such stock, (2) the number and par value of shares of each class outstanding and (3) the consideration paid for outstanding shares

6. If capital stock is outstanding, state whether any dividends or interest has been or may be paid thereon If so, give facts in detail.

7. If any distribution of corporate property of any character has ever been made to shareholders or members, attach hereto a separate statement containing full details thereof, including (1) amounts or value, (2) source of funds or property distributed, and (3) basis of and authority for distribution.

8. What specific activities is the organization presently engaged in? (Explain in detail) Providing travel information and service; rendering emergency road service; [fol. 87] publishing the Motor News; locating automobile parts for members' cars to keep them in service; providing safety education in public and parochial schools; organizing and equipping school patrols consisting of 38,000 boys and providing traffic surveys for Michigan cities in the interest of safety.

9. State all sources from which income or receipts are derived—Membership dues, advertising from the Motor News and interest on investments.

10. State the purposes for which expenditures are made—Rendering service to members.

11. State whether others than members and their guests are permitted to use the club facilities, participate in or attend tournaments conducted by the organization, etc.—No.

If so, state the amount received from these nonmember sources during the last complete year of operation, \$.

12. Is any part of the club's property rented or leased to others? If so, state the reasons for such—The Detroit Automobile Inter-Insurance Exchange, selling automobile insurance to members only of the Club, occupies

jointly with the Club a certain portion of its property for which annual financial adjustments are made.

The property was on the corner of Cass and Vernor Avenue, Detroit, Michigan. Before the property was entirely paid for we sold our interest of \$101,875.56 for \$121,253.97 in March 1925. The entire amount was applied on the cost of alterations to our present Main office building in 1926. This property was originally acquired with the intention of building a home office building for the club.

13. Has the club ever sold any real property? Yes. If so, attach hereto a complete statement thereto, including reasons for the sale or sales, amounts received, and disposition made of the proceeds.

14. Does any part of the net income inure to the benefit of any private shareholder or individual? No.

[fol. 88] 15. Attach to this affidavit a classified statement of the receipts and expenditures of the organization during the last complete year of operation and a complete statement of the assets and liabilities as of the end of that year; a copy of the articles of incorporation, if incorporated, or if not incorporated, a copy of the constitution, articles of association, or other document setting forth the aims and purposes of the organization; and a copy of the bylaws, or other similar code of regulations.

A mere claim or contention by an organization that it is exempt from income tax under section 101 of the Internal Revenue Code and the corresponding provisions of prior revenue acts, will not relieve the organization from filing income tax returns and paying the tax. Unless the Commissioner has determined that an organization is exempt, it must prepare and file a complete income tax return for each taxable year of its existence. Accordingly, every organization that claims to be exempt should furnish the information and data specified herein, together with any other facts deemed material to the question, with the least possible delay, in order that the Commissioner can determine whether or not it is exempt. As soon as practicable after the information and data are received, the organization will be advised of the Commissioner's de-

termination, and, if it is held to be exempt, no further returns of income will be required.

John A. Brown (Signature of officer making affidavit), 1st Vice President

Subscribed and sworn to before me this 5th day of June, 1945.

Fred N. Rehmi (Signature of officer administering oath), Notary Public, Comm. Ex. Jan. 21, 1946.

[Notary's Seal]

[fol. 89]

Balance Sheet

Automobile Club of Michigan
December 31, 1944.

Assets		
Cash		414,876.30
Accounts Receivable:		
Motor News, less reserve of \$1,000.00	2,003.50	
Detroit Automobile Inter-Ins. Exchange and Miscellaneous	28,901.76	30,905.26
OTHER ASSETS		
Investment securities, less reserve of \$13,000.00 to reduce to quoted market prices	1,920,689.87	
Accrued interest, claims against closed banks, and travel advances	9,501.85	1,930,191.72
Property and Equipment		100,423.14
Deferred Charges		21,810.96
		<u>2,498,207.38</u>
Liabilities		
Accounts payable:		
For expenses	100,578.99	
Salaries and commissions	5,022.95	
Payroll Taxes	7,320.17	
Miscellaneous	1,698.32	174,620.43
Deferred Income		976,115.14
Reserve For Post-War Personnel Adjustments		47,000.00
Operating Fund Reserve		1,300,471.81
		<u>2,498,207.38</u>

[fol. 90]

Exhibit B to Stipulation of Facts

July 16, 1945

IT:P:T:1

FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

Gentlemen:

Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G. C. M. 23688, C. B. 1943, 283.

Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which rulings was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.

[fol. 91] Section 101(9) of the Internal Revenue Code provides for the exemption of:

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similar provisions.

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other nonprofitable purposes", within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. [fol. 92] You are, however, required to file returns for the year 1943 and subsequent years.

By direction of the Commissioner.

Very truly yours,

(Signed) Norman D. Cann
Deputy Commissioner

FEF/mes-z

7-7-45

(Here follows 3 Pastors, folios 93, 94, 95)

[fol. 93]

EXHIBIT 9. TO STIPULATION OF FACTS

Balance Sheets

Automobile Club of Michigan

	Dec. 31-1934	Dec. 31-1935	Dec. 31-1936	Dec. 31-1937	Dec. 31-1938	Dec. 31-1939	Dec. 31-1940	Dec. 31-1941
Assets								
Cash.....	\$135,571.65	\$137,427.80	\$176,060.97	\$148,106.67	\$ 121,553.97	\$ 126,223.97	\$ 118,432.11	\$ 155,379.26
Accounts receivable, less reserve.....	13,244.02	16,630.95	19,508.77	21,149.28	20,396.44	16,599.09	19,051.61	22,382.70
Cash on deposit—reserved for the purchase of investment securities.....	—0—	15,247.52	12,760.28	7,727.00	105,619.44	105,464.63	334,222.73	442,296.00
United States Savings bonds.....	—0—	—0—	15,100.00	23,000.00	31,100.00	39,400.00	47,900.00	99,038.00
Other United States Government securities.....	87,595.78	171,290.85	201,842.70	299,401.57	315,301.57	377,926.64	368,871.70	393,238.11
Municipal bonds.....	88,625.55	80,508.25	76,908.23	70,824.89	58,725.29	76,857.95	56,980.94	56,841.72
Public utility bonds.....	—0—	15,375.00	20,425.00	106,375.00	153,537.50	152,942.88	179,269.87	179,049.99
Domestic corporation bonds.....	64,252.60	29,690.10	29,096.10	18,910.62	71,349.23	67,787.06	44,658.89	33,782.02
Domestic corporation stocks.....	3,510.00	4,178.50	53,564.62	80,593.14	84,646.96	94,516.67	94,192.75	94,192.75
Reserve to reduce securities to approximate aggregate quoted market prices.....	—0—	—0—	—0—	—0—	—0—	—0—	—0—	(24,000.00)
Accrued interest on bonds.....	10,664.31	10,995.17	12,860.14	8,477.39	7,729.79	7,976.72	3,215.49	3,488.05
Miscellaneous accounts and deposits.....	33,108.78	29,755.29	21,917.18	20,927.45	14,636.44	13,640.00	1,634.15	1,669.15
Land.....	—0—	—0—	—0—	—0—	—0—	—0—	—0—	28,522.61
Buildings.....	—0—	—0—	—0—	—0—	—0—	—0—	—0—	20,975.96
Leasehold improvements.....	177,025.73	177,025.73	—0—	—0—	—0—	—0—	—0—	—0—
Furniture and equipment.....	68,258.96	49,919.06	—0—	—0—	—0—	—0—	—0—	—0—
Automobiles and trucks.....	3,613.47	4,729.35	5,270.75	5,324.92	6,646.88	7,748.71	11,319.48	12,358.07
Reserves for depreciation.....	(182,412.40)	(186,610.78)	(1,615.65)	(1,926.88)	(2,285.60)	(2,753.58)	(2,858.43)	(2,990.91)
Deferred charges:								
Maps and supplies.....	9,650.00	10,105.61	10,331.67	10,189.69	10,184.48	10,637.39	10,537.88	10,641.89
Taxes and insurance.....	5,420.47	5,383.26	5,748.53	5,677.29	6,409.35	8,229.47	5,775.61	6,136.79
	<u>\$518,128.92</u>	<u>\$571,651.66</u>	<u>\$659,779.29</u>	<u>\$824,758.03</u>	<u>\$1,005,551.74</u>	<u>\$1,103,197.60</u>	<u>\$1,293,195.78</u>	<u>1,533,002.16</u>
Liabilities								
Accounts payable.....	\$ 16,856.93	\$ 32,543.58	\$ 52,994.67	\$ 62,584.89	\$ 74,362.42	\$ 75,303.44	\$ 107,952.26	\$ 120,360.94
Deferred income:								
Unearned membership dues.....							653,337.56	771,937.52
Collections on memberships issued on a deferred payment basis.....	3,711.86	5,064.75	6,966.71	6,497.51	10,282.80	11,093.17	11,734.48	10,125.35
Investment fluctuation and general contingency reserve.....	50,000.00	45,217.69	44,766.47	40,111.68	39,688.10	39,641.85	—0—	—0—
Net worth:								
Deferred income.....	178,832.39	194,216.13	353,181.99	479,015.93	518,232.11	570,209.37	520,171.48	630,578.35
Operating fund.....	268,727.74	294,609.51	201,869.45	236,548.02	362,986.31	406,949.77		
	<u>\$518,128.92</u>	<u>\$571,651.66</u>	<u>\$659,779.29</u>	<u>\$824,758.03</u>	<u>\$1,005,551.74</u>	<u>\$1,103,197.60</u>	<u>\$1,293,195.78</u>	<u>\$1,533,002.16</u>

EXHIBIT 10 TO STIPULATION OF FACTS

[fol. 94]

Balance Sheets
Automobile Club of Michigan

	Dec. 31-1942	Dec. 31-1943	Dec. 31-1944	Dec. 31-1945	Dec. 31-1946	Dec. 31-1947
Assets						
Cash.....	\$ 325,496.97	\$ 321,247.60	\$ 380,234.73	\$ 240,383.42	\$ 406,866.08	\$ 415,776.12
Accounts receivable, less reserve.....	26,625.11	27,412.21	30,905.26	42,739.48	25,539.36	70,472.52
Cash on deposit—reserved for the purchase of investment securities.....	17,842.55	52,920.01	34,641.57	64,629.46	—0—	—0—
United States Savings bonds.....	200,406.50	302,209.80	404,347.90	483,888.20	476,412.67	469,039.50
Other United States Government securities.....	798,676.11	1,017,179.38	1,230,179.24	1,172,375.63	1,115,039.51	1,046,059.17
Municipal bonds.....	56,702.50	56,563.28	56,424.06	51,297.36	51,158.16	51,018.96
Public utility bonds.....	178,830.61	178,611.23	163,081.93	102,900.92	102,741.56	72,301.97
Domestic corporation bonds.....	32,672.12	31,555.10	17,960.62	13,960.62	2,067.10	2,067.10
Domestic corporation stocks.....	90,650.12	67,766.12	67,766.12	—0—	—0—	—0—
Reserve to reduce securities to approximate aggregate quoted market prices.....	24,000.00	13,000.00	9,000.00	—0—	—0—	—0—
Accrued interest on bonds.....	5,435.12	7,373.16	8,399.82	7,496.50	7,139.00	6,870.82
Miscellaneous accounts and deposits.....	1,350.19	1,667.18	1,102.03	1,685.00	2,893.38	4,068.11
Land.....	28,522.61	28,522.61	64,420.64	472,731.64	491,056.64	491,056.64
Buildings.....	35,554.66	35,554.66	35,554.66	35,554.66	35,554.66	35,554.66
Automobiles and trucks.....	13,076.07	18,623.25	14,438.09	9,992.23	8,037.88	30,576.44
Reserves for depreciation.....	7,110.74	12,091.19	13,999.25	12,209.34	12,992.82	14,448.14
Deferred charges:						
Premium of pension trust fund for employees.....	—0—	—0—	14,000.00	22,739.29	27,109.40	28,896.36
Maps and supplies.....	10,300.83	—0—	—0—	—0—	—0—	—0—
Taxes, insurance, and rent.....	8,269.39	8,129.63	7,810.96	13,741.26	13,780.81	13,347.18
	<u>\$1,799,300.72</u>	<u>\$2,130,244.03</u>	<u>\$2,498,207.38</u>	<u>\$2,723,906.33</u>	<u>\$2,752,403.39</u>	<u>\$2,722,657.41</u>
Liabilities						
Accounts payable.....	\$ 117,400.72	\$ 139,831.90	\$ 174,620.43	\$ 285,017.37	\$ 298,248.96	\$ 266,728.09
Deferred income:						
Unearned membership dues.....	753,229.15	888,924.50	972,917.41	1,049,902.85	1,198,902.97	1,263,426.79
Collections on memberships issued on a deferred payment basis.....	6,934.28	3,981.30	2,867.73	3,081.10	—0—	—0—
Unearned advertising revenue.....	1,542.73	1,275.48	330.00	—0—	—0—	—0—
Reserve for post-war personnel adjustments.....	—0—	50,000.00	47,000.00	—0—	—0—	—0—
Building fund reserve.....	—0—	—0—	—0—	—0—	—0—	925,000.00
Operating fund reserve:						
Balance at beginning of year.....	630,578.35	920,193.84	1,046,230.85	1,300,471.81	1,385,905.01	1,255,251.46
Write-off of inventories of office supplies, maps, and emblems.....	—0—	9,550.00	—0—	—0—	—0—	—0—
Adjustments to surplus reserves.....	—0—	39,000.00	3,000.00	66,000.00	—0—	925,000.00
Federal capital stock tax applicable to prior year.....	—0—	—0—	—0—	12,312.50	—0—	—0—
Net income for the year.....	289,615.49	174,587.01	257,240.96	32,245.70	130,653.55	62,748.93
	<u>\$1,799,300.72</u>	<u>\$2,130,244.03</u>	<u>\$2,498,207.38</u>	<u>\$2,723,906.33</u>	<u>\$2,752,403.39</u>	<u>\$2,722,657.41</u>

NOTE: Italic figures shown in red on original.

The amount of the reserve deducted from accounts receivable in the balance sheets is \$1,000.00 for each year.

The operating fund reserve at the beginning of the year 1942 reflects a net charge of \$1,786.61 in connection with the acquisition of other clubs prior to January 1, 1943.

EXHIBIT 11 TO STIPULATION OF FACTS

Statements of Income and Expense

Automobile Club of Michigan

Year Ended

	Dec. 31-1934	Dec. 31-1935	Dec. 31-1936	Dec. 31-1937	Dec. 31-1938	Dec. 31-1939	Dec. 31-1940	Dec. 31-1941
Membership dues.....	\$542,183.39	\$604,494.29	\$840,480.78	\$1,155,980.00	\$1,199,988.23	\$1,324,940.33	\$1,489,785.97	\$1,770,375.31
Sales of maps and guides.....	1,823.80	530.00	566.77	382.00	247.05	314.20	249.82	207.57
Rental income.....	52,584.00	52,584.00	52,584.00	56,184.00	56,184.00	50,027.88	47,300.48	40,754.77
Interest earned.....	8,171.37	8,337.69	12,621.05	11,532.11	15,431.68	15,080.05	16,104.92	17,978.09
Dividends received.....	—0—	—0—	—0—	3,100.50	3,543.40	4,007.00	4,273.00	4,564.00
Motor News advertising.....	23,744.92	35,635.92	37,752.23	44,105.68	37,613.37	45,067.12	52,851.13	54,217.27
Gain on disposal of investment securities.....	—0—	—0—	—0—	—0—	—0—	—0—	510.44	181.50
Gain on disposal of automobiles.....	—0—	—0—	—0—	—0—	—0—	—0—	510.60	—0—
Unclassified.....	437.66	523.81	895.82	1,054.98	563.28	786.80	636.33	2,590.16
Gross Income	\$628,945.14	\$72,105.71	\$944,900.65	\$1,272,339.27	\$1,313,571.01	\$1,440,223.38	\$1,612,222.69	\$1,890,868.67
Expenses.....	607,930.48	660,840.20	855,037.61	1,122,326.76	1,147,916.54	1,304,685.10	1,450,979.98	1,637,861.84
Net Income (on the basis of dues collected)...	\$ 21,014.66	\$ 41,265.51	\$ 89,863.04	\$ 150,012.51	\$ 165,654.47	\$ 135,538.28	\$ 161,242.71	\$ 253,006.83
Deduct adjustment for unearned membership dues, less commissions applicable thereto.....							83,128.19	118,599.96
Net Income (on the basis of dues earned)							\$ 78,114.52	\$ 134,406.87

[fol. 96]

EXHIBIT 12 TO STIPULATION OF FACTS

Statements of Income and Expense

Automobile Club of Michigan

	Year Ended					
	Dec. 31-1942	Dec. 31-1943	Dec. 31-1944	Dec. 31-1945	Dec. 31-1946	Dec. 31-1947
Membership dues.....	\$1,862,822.31	\$1,993,695.13	\$2,154,137.70	\$2,353,345.16	\$2,598,978.63	\$2,849,504.94
Sales of maps and guides.....	58.80	61.05	64.40	50.15	57.45	
Rental income.....	36,936.48	36,936.48	37,623.25	39,956.48	58,567.52	48,756.48
Interest earned.....	28,593.82	34,420.90	40,429.10	46,051.06	41,374.74	39,425.75
Dividends received.....	3,905.00	2,885.00	2,560.00	1,195.00	—0—	—0—
Motor News advertising.....	43,184.90	47,829.50	59,366.55	71,713.14	81,452.50	82,148.00
Gain on disposal of investment securities.....	729.78	1,040.32	564.08	4,538.43	1,896.59	3,927.15
Gain on disposal of automobiles.....	—0—	—0—	—0—	—0—	913.67	14,215.23
Unclassified.....	1,107.53	1,379.78	1,843.80	265.64	4,333.98	7,279.45
Gross Income	\$1,977,338.62	\$3,118,612.16	\$2,296,588.88	\$2,508,038.20	\$2,787,575.08	\$3,045,257.00
Expenses.....	1,687,723.13	1,944,025.15	2,039,347.92	2,475,792.50	2,918,228.63	3,108,005.93
Net Income—Loss	\$ 289,615.49	\$ 174,587.01	\$ 257,240.96	\$ 32,245.70	\$ 130,653.55	\$ 62,748.93

NOTE: Words and figures in italics shown in red on original.

[fol. 97]

EXHIBIT 13 TO STIPULATION OF FACTS

Form 1120
Treasury Department
Internal Revenue Service

United States

Corporation Income and Declared Value
Excess-Profits Tax Return

For Calendar Year 1943

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan
Kind of business—Automobile club

Normal-Tax Net Income Computation
Gross Income

4. Gross receipts (where inventories are not an income-determining factor) . . .	\$1,993,695.13		
6. Gross profits where inventories are not an income-determining factor	\$1,993,695.13		
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.			774.15
8. Interest on corporation bonds,			
		Less:	
		Amortizable	
		Bond	
		Premium	
etc.	\$6,737.50	\$ 296.90	6,440.60
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to March 1, 1941. (From Schedule M, line 15 (a) (2) (iii))	10,154.27	1,482.81	8,671.46
9. (b) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Sumbit schedule)	17,500.33	13.92	17,486.41
10. Rents			36,936.48
12. (a) Net gain from sale or exchange of capital assets. (From Schedule C)			1,404.32
13. Dividends. (From Schedule E)			2,885.00
14. Other income. (State nature) Schedule attached			50,652.43
15. Total income in items 3, and 6 to 14, inclusive			\$2,118,945.98

[fol. 98]

Deductions

16.	Compensation of officers. (From Schedule F).....	\$ 35,100.00	
17.	Salaries and wages (not deducted elsewhere).....	542,247.01	
18.	Rent.....	72,570.26	
19.	Repairs.....	8,892.59	
20.	Bad debts. (From Schedule G).....	375.00	
22.	Taxes. (From Schedule H) (Deduct declared value excess-profits tax as item 34).....	33,371.74	
23.	Contributions or gifts paid. (From Schedule I) \$14,750.00, limited to.....	8,555.27	
25.	Depreciation. (From Schedule J).....	14,355.82	
29.	Other deductions authorized by law. (From Schedule K).....	1,241,813.85	
30.	Total deductions in items 16 to 29, inclusive.....		1,957,281.54
31.	Net income for declared value excess-profits tax computation (item 15 minus item 30).....		\$ 161,664.44
32.	Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 15 (a) (3) (ii))..... \$1,025.00 Less amortizable bond premiums, \$139.22.....		885.75
33.	Total of lines 31 and 32.....		\$ 162,550.19
34.	Less: Declared value excess-profits tax.....		—0—
35.	Net income.....		\$ 162,550.19
36.	Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of lines 9 (a) and 32).....		9,557.21
37.	Adjusted net income.....		\$ 152,992.98
38.	Less: Income subject to excess profits tax. (From Form 1121).....	\$35,867.06	
39.	Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 37 minus item 38, above).....	2,452.25	38,319.31
40.	Normal-tax net income.....		\$ 114,673.67
Total Income and Declared Value Excess-Profits Taxes			
41.	Total income tax (line 28 or 50, page 2, whichever is applicable).....		
42.	Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation. Exemption claimed as set forth in attached rider.....		
44.	Total declared value excess-profits tax (line 8, page 2).....		No Tax

[fol. 99]

Affidavit. (See Instruction E)

We, the undersigned, president (or vice-president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

"John E. Brown" 1st. B. Pres.

"J. C. Sasser" Ass't Treas.

(Corporate Seal)

Subscribed and sworn to before me this 18th day of October, 1945.

"Fred N. Rehm" Notary Public

Expires Jan. 21, 1946

(Notarial Seal)

Affidavit. (See Instruction E)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

M. M. Jensen

Ernst & Ernst

Subscribed and sworn to before me this 18th day of October, 1945.

Esther L. Trout Notary Public

My commission expires May 28, 1946

(Notarial Seal)

Page 2

Declared Value Excess-Profits Tax Computation

(See Computation Instructions)

1. Net income for declared value excess-profits tax computation (item 31, page 1).....		\$161,664.41
2. Value of capital stock as declared in your capital stock tax return for the year ended June 30, 1943 (or for year ended June 30, 1944, if your income tax fiscal year began in 1943 and ended on or after July 31, 1944).....	\$3,250,000.00	
3. 10 percent of line 2.....	\$ 325,000.00	
4. Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 37 minus item 38, page 1).....	2,452.25	327,452.25
5. Balance subject to declared value excess-profits tax (line 1 minus total of lines 3 and 4).....		None

[fol. 100]

Schedule E.—Income From Dividends

Schedule attached

Schedule F.—Compensation of Officers

1. Name and Address of Officer	2. Official Title	3. Time Devoted to Business	6. Amount of Compensation
Richard Harfst	Assistant Secretary and General Manager	All	\$23,000.00
J. C. Sasser	Assistant Treasurer	All	12,100.00
Total compensation of officers. (Enter as item 16, page 1)			\$35,100.00

Schedule G.—Bad Debts. (See Instruction 20) (See notes 1 and 2)

1. Taxable Year	5 Gross Amount Added to Reserve
1943	\$375.00

1. Check whether deduction claimed represents debts which have become worthless [X], or is an addition to a reserve [].
2. Not including securities which are capital assets and which became worthless within the taxable year. Such securities which became worthless within the year should be reported in Schedule C.

Schedule H.—Taxes.
(See Instruction 22)

Nature	Amount
Pay roll taxes	\$16,107.31
Local property taxes	8,726.93
Federal capital stock	8,537.50
Total. (Enter as item 22, page 1)	\$33,371.74

Schedule I.—Contributions or Gifts Paid. (See Instruction 23)

Name and Address of Organization	Amount
American Red Cross	\$ 5,000.00
War Chest of Metropolitan Detroit	9,750.00
Total. (Enter as item 23, page 1, subject to 5 percent limitation.) (See Instruction 23)	\$14,750.00

[fol. 101]

Schedule K.—Other Deductions (See Instruction 29)

Schedule attached

Questions

1. Date of incorporation—July 21, 1916.
2. State or country—Michigan.
3. State collector's office where the corporation's return for the preceding year was filed—None required.
4. The corporation's books are in care of J. C. Sasser. Located at 139 Bagley Avenue, Detroit.
5. Number of places of business—34.
6. Did the corporation during the taxable year have any Government contracts or subcontracts? (Answer "yes" or "no"). No. If answer is "yes," state the approximate aggregate gross dollar amount billed during the taxable year under all such contracts and/or subcontracts. (See Instruction G-(3).)
7. Is the corporation a personal holding company within the meaning of section 501 of the Internal Revenue Code? -No. (If so, an additional return on Form 1120 H must be filed.)
8. Is this a consolidated return? No. (If so, procure from the collector of internal revenue for your district Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of this return.)
9. If this is not a consolidated return: (a) did you own at any time during the taxable year 50 percent or more of the voting stock of another corporation either domestic or foreign? No; or (b) did any corporation, individual, partnership, trust, or association own at any time during the taxable year 50 percent or more of your voting stock? Not applicable. (If either answer is "yes," attach separate schedule showing: (1) Name and address; (2) percentage of stock owned; (3) date stock was acquired; and (4) the collector's office in which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed.)
10. Is this return made on the basis of cash receipts and disbursements? No. If not, describe fully in separate statement.
11. Did the corporation at any time during its taxable year have in its employ more than eight individuals? (Answer "yes" or "no") Yes. If answer is "yes," has the corporation in this return taken a deduction for any amount of wages or salaries representing an increase or decrease in rate? (Answer "yes" or "no") Yes. If answer to second question is "yes," attach statement explaining all such increases or decreases. If any of such increases or decreases required the prior approval of the National War Labor Board or the Commissioner of Internal Revenue as stated in Instruction 16, attach also a copy of the authorization for each of such increases or decreases.
12. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. Not applicable. If other basis is used, explain fully in separate statement, giving date inventory was last reconciled with stock.
13. Did the corporation make a return of information on Forms 1096 and 1099 or Forms V-2 and W-2 for the calendar year 1943 (see Instruction G-(1))? Yes.
14. Did the corporation at any time during the taxable year own directly or indirectly any stock of a foreign corporation? (Answer "yes" or "no") No. (If answer is "yes," attach statement as required by Instruction K-(3).)

[fol. 102]

Page 4

Schedule L.—Balance Sheets. (See Instruction L)

Assets	Beginning of Taxable Year Amount	Total	End of Taxable Year Amount	Total
1. Cash.....	\$ 343,339.52		\$ 374,167.61	
2. Notes and accounts re- receivable.....	\$ 27,625.11		\$ 28,412.21	
Less: Reserve for bad debts.....	1,000.00	26,625.11	1,000.00	27,412.21
3. Inventories (itemize in sep- arate schedule).....		10,300.83		<u>—0—</u>
4. Investments in govern- mental obligations:				
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Colum- bia, or United States possessions.....	\$ 56,702.50		\$ 56,563.28	
(b) Obligations of the United States:				
(2) United States savings bonds and Treasury bonds is- sued prior to March 1, 1941....	370,847.34		335,864.53	
(3) Treasury notes is- sued on or after December 1, 1940; and all other obli- gations of the United States is- sued on or after March 1, 1941....	628,235.27		983,524.65	
(c) Obligations of instru- mentalities of the United States:				
(3) Obligations of all instrumentalities of the United States issued on or after March 1, 1941....		1,055,785.11		1,375,952.46
5. Other investments (item- ize).....		302,152.85		277,932.45
6. Capital assets:				
(a) Depreciable assets (itemize in separate schedule).....	48,630.73		54,177.91	
Less: Reserve for de- preciation.....	7,110.74	41,519.99	12,091.19	42,086.72
(c) Land.....		28,522.61		28,522.61
7. Other assets (itemize).....		15,054.70		17,169.97
8. Total Assets.....		<u>\$1,823,300.72</u>		<u>\$2,143,244.03</u>

[fol. 103]

Liabilities

9. Accounts payable.....	\$ 117,400.72	\$ 139,831.90
12. Other liabilities (itemize):		
Deferred dues.....	\$760,163.43	\$892,905.80
Unearned advertising...	1,542.73	894,181.28
13. Surplus reserves (itemize in separate schedule).....	24,000.00	63,000.00
16. Earned surplus and un- divided profits.....	920,193.84	1,046,230.85
17. Total Liabilities.....	\$1,823,300.72	\$2,143,244.03

Excess Profits Tax. (See Instructions for Form 1121)

(a) Is an excess profits tax return on Form 1121 being filed for the taxable period covered by this return? Yes.

Automobile Club of Michigan
Detroit, Michigan

Statement Attached to 1943 Corporation Income and
Declared Value Excess Profits Tax Return

The attached 1943 Corporation Income and Declared Value Excess Profits Tax Return of Automobile Club of Michigan is filed under protest for the reason that the Automobile Club of Michigan believes that it is exempt from income tax under Section 101-9 of the Internal Revenue Code.

Rulings of the Commissioner of Internal Revenue under dates of June 11, 1934, and July 5, 1938, specifically held that the Automobile Club of Michigan was exempt from the imposition of Federal income taxes under the provisions of said Section of the Code. Said rulings likewise relieved the Automobile Club of Michigan of liability for filing Federal corporation income tax returns. A letter from Mr. Norman D. Cann, Deputy Commissioner of Internal Revenue, under date of July 16, 1945, purports to revoke the Bureau's Rulings aforesaid and directs that the Automobile Club of Michigan file a Federal corporation income tax return for the calendar year 1943. The attached return is filed solely by reason of the receipt of the aforesaid letter and pursuant to its requirements.

The attached corporation income tax return shows items of gross income received by the Automobile Club of Michigan for the calendar year 1943 and deductions properly allowable and the amount of net income resulting. It does not show any tax computation because the Automobile Club of Michigan deems that the aforesaid purported revocation is contrary to the provisions of the Internal Revenue Code applicable to the Automobile Club of Michigan. Consequently no tax is being paid herewith.

The attached 1943 return was not filed at the time required by law for the filing of 1943 corporation income tax returns for the reason that on said date there was a ruling of the Commissioner of Internal Revenue in effect, holding that the Automobile Club of Michigan was exempt from taxation under Section 101-9 of the Internal Revenue Code. The attached corporation income tax return is being filed pursuant to instructions at as early a date following the receipt of the letter of Mr. Norman D. Cann above referred to as pos-

[fol. 104]

sible, since the preparation of this and other returns required by said letter required a substantial amount of time. Delay in filing this corporation income tax return is due to the aforesaid cause and is not due to wilful negligence or intent to evade tax on the part of the Automobile Club of Michigan.

Automobile Club of Michigan
By "John E. Brown"

1st Vice President

By "J. C. Sasser"

Assistant Treasurer

Dated: October 17, 1945

EXHIBIT 14 TO STIPULATION OF FACTS

Internal Revenue Service
Treasury Department
Form 1121

Page 1

United States
Corporation Excess Profits Tax Return
For Calendar Year 1943

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

Excess Profits Tax Computation

Item and Instruction No.	Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1. Excess profits net income (line 16, Schedule A)	\$148,703.66	
2. Specific exemption	\$ 5,000	\$ 5,000
3. Excess profits credit—based on income (line 46, Schedule B)		X X X X X X
4. Excess profits credit—based on invested capital (line 41, Schedule C)	X X X X X X	
5. Unused excess profits credit adjustment (attach schedule)	107,836.60	
6. Total of items 2 to 5	\$112,836.60	\$
7. Difference between item 1 and item 6	\$ 35,867.06	\$
8. Adjusted excess profits net income (Item 7, column 1 or column 2, whichever is applicable)		\$35,867.06
20. Item 18 (c) minus item 19		\$
Exemption claimed as set forth in attached rider		
24. Excess profits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)		\$ No tax

[fol. 105]

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

"John E. Brown" 1st. V. Pres.

"J. C. Sasser" Ass't. Treas.

(Corporate Seal)

Subscribed and sworn to before me this 18th day of October, 1945.

"Fred N. Rehm" Notary Public

Expires Jan. 21, 1946

(Notarial seal)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules or statements) is a true, correct, and complete statement of all the information respecting the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

M. M. Jensen

Ernst & Ernst

Subscribed and sworn to before me this 18th day of October, 1945.

Esther L. Trout Notary Public

My commission expires May 28, 1946

(Notarial Seal)

Page 2

Questions

- (a) Date of incorporation—July 21, 1916. (b) State or country—Michigan.
- (c) Collector's office in which your income tax return for the taxable year was filed—Detroit.
- (d) Is this a consolidated return? No. If so, procure from the collector Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of the consolidated income tax return.
- (e) In computing the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced by the amount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b) (4) of the Internal Revenue Code? (Answer "yes" or "no")—Yes
- (f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no")—No.
- (g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no")—No.
- (h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), \$2,143,244.03.

[fol. 106]

Schedule A.—Excess Profits Net Income Computation

Line No.	Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1. Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 37, page 1, Form 1120).....	\$152,992.98	\$.....
7. Total of lines 1 to 6.....	\$152,992.98	\$.....
8. Net gain from sale or exchange of capital assets (item 12 (a), page 1, Form 1120).....	\$ 1,404.32	\$.....
13. (a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations).....	2,885.00	X X X X X X
15. Total of lines 8 to 14.....	\$ 4,289.32	\$.....
16. Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15).....	\$148,703.66	\$.....
18. Excess profits net income computed under income credit method or invested capital credit method (line 16; or line 16 minus line 17 in case of a life insurance company)...	\$148,703.66	\$.....

[fol. 107]

Schedule B.—Excess Profits Credit—Based on Income

Page 3

Taxable Years beginning After December 31, 1935,
and before January 1, 1940
(If additional columns are required, attach
separate schedule)

Line No.	1. Year Ended Dec. 31, 1936	2. Year Ended Dec. 31, 1937	3. Year Ended Dec. 31, 1938	4. Year Ended Dec. 31, 1939
1. Normal-tax (or special-Class) net income—Schedule attached.....	\$69,424.15	\$21,239.38	\$113,620.14	\$ 67,418.97
2. Net capital loss used in computing line 1.....	451.22	2,000.00	423.58	46.25
6. Total of lines 1 to 5.....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
11. Difference between lines 6 and 10.....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
14. Total of lines 11 to 13....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
18. Normal-tax (or special-class) net income after applying section 711 (b) (2) (line 14 minus line 17).....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
20. Dividends received credit....		2,635.43	3,011.89	3,405.95
26. Total of lines 18 to 25....	\$68,972.93	\$25,874.81	\$117,055.61	\$ 70,871.17
28. Dividends received from domestic corporations.....	1,250.00	3,100.50	3,543.40	4,007.00
30. Total of lines 27 to 29....	\$ 1,250.00	\$ 3,100.50	\$ 3,543.40	\$ 4,007.00
31. Excess profits net income (line 26 minus line 30).....	\$70,222.93	\$22,774.31	\$113,512.21	\$ 66,864.17
32. Net aggregate of columns 1, 2, 3, and 4.....				\$132,927.76
33. Increase in lowest year in base period (attach statement).....				121,010.60
34. Total of lines 32 and 33.....				\$253,938.36
35. Average base period net income—General average (line 34 divided by number of months in base period, multiplied by 12).....				\$ 63,484.59

[fol. 108]

36. Net aggregate of columns 3 and 4, line 31 (see instruction regarding limitation applicable to taxable year ending after May 31, 1940).....	\$180,376.38	
37. Net aggregate of columns 1 and 2, line 31.....	47,448.62	
38. Excess of line 36 over line 37.....	\$227,825.00	
39. One-half of line 38.....	113,912.50	
40. Line 36 plus line 39.....	\$294,288.88	
41. Line 40 divided by number of months in second half of base period, multiplied by 12.....	\$147,144.44	
42. Average base period net income—Increased earnings in last half of base period (line 41, or the highest excess profits net income for any taxable year in the base period, whichever is lesser) Year 1938.....		\$113,512.21
43. 95 percent of line 35 or line 42, whichever is greater.....		\$107,836.60
46. Excess profits credit—based on income (line 43 plus line 45, if a net capital addition) (or line 43 minus line 45, if a net capital reduction).....		\$107,836.60

[fol. 109]

Automobile Club of Michigan
Detroit, Michigan

Statement Attached to
1943 Corporation Excess Profits Tax Return

The attached 1943 Corporation Excess Profits Tax Return of Automobile Club of Michigan is filed under protest for the season that the Automobile Club of Michigan believes that it is exempt from income tax under Section 101-9 of the Internal Revenue Code.

Rulings of the Commissioner of Internal Revenue under dates of June 11, 1934, and July 5, 1938, specifically held that the Automobile Club of Michigan was exempt from the imposition of Federal taxes under the provisions of said Section of the Code. Said rulings likewise relieved the Automobile Club of Michigan of liability for filing Federal corporation income tax returns. A letter from Mr. Norman D. Cann, Deputy Commissioner of Internal Revenue, under date of July 16, 1945, purports to revoke the Bureau's rulings aforesaid and directs that the Automobile Club of Michigan file Federal returns for the calendar year 1943. The attached return is filed solely by reason of the receipt of the aforesaid letter and pursuant to its requirements.

The attached corporation excess profits tax return shows the excess profits net income and adjusted excess profits net income received by the Automobile Club of Michigan for the calendar year 1943 and the base period net income of the years 1936 to 1939, inclusive. It does not show any tax computation because the Automobile Club of Michigan deems that the aforesaid purported revocation is contrary to the provisions of the Internal Revenue Code applicable to the Automobile Club of Michigan. Consequently no tax is being paid herewith.

The attached 1943 return was not filed at the time required by law for the filing of 1943 corporation excess profits tax returns for the reason that on said date there was a ruling of the Commissioner of Internal Revenue in effect, holding that the Automobile Club of Michigan was exempt from taxation under Section 101-9 of the Internal Revenue Code. The attached corporation excess profits tax return is being filed pursuant to instructions, at as early a date following the receipt of the letter of Mr. Norman D. Cann above referred to as possible, since the preparation of this and other returns required by said letter required a substantial amount of time. Delay in filing this corporation excess profits tax return is due to the aforesaid cause and is not due to wilful negligence or intent to evade tax on the part of the Automobile Club of Michigan.

Automobile Club of Michigan
By "John E. Brown"
1st Vice President
By "J. C. Sasser"
Assistant Treasurer

Dated: October 17, 1945.

[fol. 110]

EXHIBIT 15 TO STIPULATION OF FACTS

Form 1120
Treasury Department
Internal Revenue Service

United States
Corporation Income and Declared Value
Excess-Profits Tax Return
For Calendar Year 1944

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan
Kind of business: Automobile Club

Normal-Tax Net Income Computation
Gross Income

4. Gross receipts (where inventories are not an income-determining factor)....	\$2,154,137.70		
6. Gross profit where inventories are not an income-determining factor.....	\$2,154,137.70		
		Less:	
		Amortizable	
		Bond	
		Premium	
8. Interest on corporation bonds, etc.....	\$ 6,536.01	\$ 292.86	6,243.15
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to March 1, 1941. (From Schedule M, line 15 (a) (2) (iii).....	8,625.00	1,056.22	7,568.78
(b) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Submit schedule)	25,582.81	13.92	25,568.89
10. Rents.....			37,623.25
13. Dividends. (From Schedule E).....			2,560.00
14. Other income. (State nature) Schedule attached.....			62,776.09
15. Total income in items 3, and 6 to 14, inclusive.....			\$2,296,477.86

[fol. 111]

Deductions

16.	Compensation of officers. (From Schedule F)	\$ 35,496.02	
17.	Salaries and wages (not deducted elsewhere)	577,533.56	
18.	Rent	78,132.15	
19.	Repairs	23,821.13	
22.	Taxes. (From Schedule H) (Deduct declared value excess-profits tax as item 35)	28,546.40	
23.	Contributions or gifts paid. (From Schedule I) \$15,700.00 limited to	12,200.53	
25.	Depreciation. (From Schedule J)	15,947.69	
29.	Other deductions authorized by law. (From Schedule K)	1,294,440.17	
30.	Total deductions in items 16 to 29, inclusive		2,066,117.65
31.	Net income for declared value excess-profits tax computation (item 15 minus item 30)		\$ 230,360.21
32.	Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 15 (a) (3) (ii) \$1,025.00. Less amortizable bond premiums, \$139.22		885.78
33.	Excess of net long-term capital gain over net short-term capital loss. (From Schedule C)		564.08
34.	Total of lines 31, 32, and 33	\$ 231,810.07	
35.	Less: Declared value excess-profits tax		—0—
36.	Net income	\$ 231,810.07	
37.	Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of lines 9 (a) and 32)		8,454.56
38.	Adjusted net income	\$ 223,355.51	
39.	Less: Adjusted excess profits net income from Form 1121. (See instruction on page 8)	\$102,394.83	
40.	Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 38 minus item 39, above)	2,176.00	104,570.83
41.	Normal-tax net income		\$ 118,784.68

Total Income and Declared Value Excess-Profits Taxes

Exemption claimed as set forth in attached rider

46.	Total income and declared value excess-profits taxes due	\$	No tax
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[fol. 112]

Affidavit. (See Instruction E)

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

"John E. Brown" 1st V. Pres.

"J. C. Sasser" Ass't. Treas.

(Corporate Seal)

Subscribed and sworn to before me this 18th day of October, 1945.

"Fred N. Rehm" Notary Public

Expires: Jan. 21, 1946

(Notarial Seal)

Affidavit. (See Instruction E)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

M. M. Jensen

Ernst & Ernst

Subscribed and sworn to before me this 18th day of October, 1945.

Esther L. Trout Notary Public

My commission expires May 28, 1946

(Notarial Seal)

Page 2

Declared Value Excess-Profits Tax Computation.

(See Computation Instructions)

- | | | |
|--|----------------|--------------|
| 1. Net income for declared value excess-profits tax computation (item 31, page 1)..... | | \$230,360.21 |
| 2. Value of capital stock as declared in your capital stock tax return for the year ended June 30, 1944 (or for year ended June 30, 1945, if your income tax fiscal year began in 1944 and ended on or after July 31, 1945)... | \$3,500,000.00 | |
| 3. 10 percent of line 2..... | \$ 350,000.00 | |
| 4. Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 38 minus item 39, page 1)..... | 2,176.00 | 352,176.00 |
| 5. Balance subject to declared value excess-profits tax (line 1 minus total of lines 3 and 4)..... | | None |

[fol. 113]

Schedule E.—Income From Dividends

Page 3

Schedule attached

Schedule F.—Compensation of Officers

1. Name and Address of Officer	2. Official Title	3. Time Devoted to Business	6. Amount of Compensation
Richard Harfst	Asst. Sec.	All	\$22,999.92
J. C. Sasser	Asst. Treas.	All	12,496.10
Total compensation of officers. (Enter as item 16, page 1)			\$35,496.02

Schedule H.—Taxes.
(See Instruction 22)Schedule I.—Contributions or
Gifts Paid. (See Instruction 23)

Nature	Amount	Name and Address of Organization	Amount
Pay roll taxes	\$15,476.98	War Chest of Metropolitan Detroit	\$ 5,000.00
Local property taxes	8,694.42	American Red Cross	10,700.00
Federal capital stock tax	4,375.00		
Total. (Enter as item 22, page 1)	\$28,546.40	Total. (Enter as item 23, page 1; subject to 5 percent limitation.) (See Instruction 23)	\$15,700.00

Schedule J.—Depreciation. (See Instruction 25)

Schedule attached

Schedule K.—Other Deductions. (See Instruction 29)

Schedule attached

Questions

1. Date of incorporation—July 21, 1916.
2. State or country—Michigan.
3. State collector's office where the corporation's return for the preceding year was filed—None required.
4. The corporation's books are in care of J. C. Sasser. Located at 139 Bagley Ave., Detroit.
5. Number of places of business—34.
6. Did the corporation during the taxable year have any Government contracts or subcontracts? (Answer "yes" or "no"). No. If answer is "yes," state the approximate aggregate gross dollar amount billed during the taxable year under all such contracts and/or subcontracts. (See Instruction G-(3).)

[fol. 114]

7. Is the corporation a personal holding company within the meaning of section 501 of the Internal Revenue Code? No. (If so, additional return on Form 1120 H must be filed.)
8. Is this a consolidated return? No. (If so, procure from the collector of internal revenue for your district Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of this return.)
9. If this is not a consolidated return: (a) did the corporation own at any time during the taxable year 50 percent or more of the voting stock of another corporation either domestic or foreign? No; or (b) did any corporation, individual, partnership, trust, or association own at any time during the taxable year 50 percent or more of the corporation's voting stock? No. (If either answer is "yes" attach separate schedule showing: (1) Name and address; (2) percentage of stock owned; (3) date stock was acquired; and (4) the collector's office in which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed.)
10. Is this return on the basis of cash receipts and disbursements? No. If not, describe fully in separate statement. Accrual.
11. Did the corporation at any time during its taxable year have in its employ more than eight individuals? (Answer "yes" or "no"). Yes. If answer is "yes," has the corporation in this return taken a deduction for any amount of wages or salaries representing an increase or decrease in rate? (Answer "yes" or "no"). Yes. If answer to second question is "yes," attach statement as required by Instructions 16 and 17.
12. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. No inventories. If other basis is used, explain fully in separate statement, giving date inventory was last reconciled with stock.
13. Did the corporation make a return of information on Forms 1096 and 1099 or Form W-2 (or Form W-2a) for the calendar year 1944 (see Instruction G-(1))? Yes.
14. Has any transaction described in Instruction G-(4) occurred on or after October 8, 1940? (Answer "yes" or "no"). No.
15. Did the corporation at any time during the taxable year own directly or indirectly any stock of a foreign corporation? (Answer "yes" or "no"). No. (If answer is "yes," attach statement as required by Instruction W-(3).)

[fol. 115]

Page 4

Schedule L.—Balance Sheets. (See Instruction L)

Assets	Beginning of Taxable Year Amount	Total	End of Taxable Year Amount	Total
Assets	Beginning of Taxable Year Amount	Total	End of Taxable Year Amount	Total
1. Cash.....		\$ 374,167.61		\$ 414,876.30
2. Notes and accounts receivable.	\$ 28,412.21		\$ 31,905.26	
Less: Reserve for bad debts.	1,000.00	27,412.21	1,000.00	30,905.26
3. Inventories (itemize in separate schedule).....		—0—		—0—
4. Investments in governmental obligations:				
(a) Obligations of a State, Ter- ritory, or political subdivi- sion thereof, or the District of Columbia, or United States possessions.....	\$ 56,563.28		\$ 56,424.06	
(b) Obligations of the United States:				
(2) United States savings bonds and Treasury bonds issued prior to March 1, 1941.....	335,864.53		300,508.31	
(3) Treasury notes issued on or after December 1, 1946; and all other ob- ligations of the United States issued on or after March 1, 1941...	983,524.65			
(c) Obligations of instrumen- talities of the United States:				
(3) Obligations of all in- strumentalities of the United States issued on or after March 1, 1941.		1,375,952.46	1,333,948.83	1,690,881.20
5. Other investments (itemize)...		277,932.45		248,808.67
6. Capital assets:				
(a) Depreciable assets (itemize in separate schedule).....	\$ 54,177.91		\$ 49,992.75	
Less: Reserve for deprecia- tion.....	12,091.19	42,086.72	13,999.25	35,993.50
(c) Land.....		28,522.61		64,429.64
7. Other assets (itemize).....		17,169.97		31,312.81
8. Total Assets.....		\$2,143,244.03		\$2,517,207.38

[fol. 116]

Liabilities

9. Accounts payable.....	\$ 139,831.90	\$ 174,620.43
11. Accrued expenses (itemize).....	\$ 975,785.14	
	330.00	976,115.14
12. Other liabilities (itemize):		
Deferred dues.....	\$892,905.80	
Unearned advertising.....	1,275.48	894,181.28
13. Surplus reserves (itemize in separate schedule).....	63,000.00	66,000.00
16. Earned surplus and undivided profits.....	1,046,230.85	1,300,471.81
17. Total Liabilities.....	<u>\$2,143,244.03</u>	<u>\$2,517,207.38</u>

**Automobile Club of Michigan
Detroit, Michigan**

**Statement Attached to 1944 Corporation Income and
Declared Value Excess Profits Tax Return**

The attached 1944 Corporation Income and Declared Value Excess Profits Tax Return of Automobile Club of Michigan is filed under protest for the reason that the Automobile Club of Michigan believes that it is exempt from income tax under Section 101-9 of the Internal Revenue Code.

Rulings of the Commissioner of Internal Revenue under dates of June 11, 1934, and July 5, 1938, specifically held that the Automobile Club of Michigan was exempt from the imposition of Federal income taxes under the provisions of said Section of the Code. Said rulings likewise relieved the Automobile Club of Michigan of liability for filing Federal corporation income tax returns. A letter from Mr. Norman D. Cann, Deputy Commissioner of Internal Revenue, under date of July 16, 1945, purports to revoke the Bureau's rulings aforesaid and directs that the Automobile Club of Michigan file a Federal corporation income tax return for the calendar year 1944. The attached return is filed solely by reason of the receipt of the aforesaid letter and pursuant to its requirements.

The attached corporation income tax return shows items of gross income received by the Automobile Club of Michigan for the calendar year 1944 and deductions properly allowable and the amount of net income resulting. It does not show any tax computation because the Automobile Club of Michigan deems that the aforesaid purported revocation is contrary to the provisions of the Internal Revenue Code applicable to the Automobile Club of Michigan. Consequently no tax is being paid herewith.

The attached 1944 return was not filed at the time required by law for the filing of 1944 corporation income tax returns for the reason that on said date there was a ruling of the Commissioner of Internal Revenue in effect, holding that the Automobile Club of Michigan was exempt from taxation under Section 101-9 of the Internal Revenue Code. The attached corporation income tax return is being filed pursuant to instructions at as early a date following the receipt of the letter of Mr. Norman D. Cann above referred to as possible, since the preparation of this and other returns required by said letter re-[fol. 117] quired a substantial amount of time. Delay in filing this corporation income tax return is due to the aforesaid cause and is not due to wilful negligence or intent to evade tax on the part of the Automobile Club of Michigan.

Automobile Club of Michigan
By "John E. Brown"
1st Vice President
By "J. C. Sasser"
Assistant Treasurer

Dated: October 17, 1945

EXHIBIT 16 TO STIPULATION OF FACTS

Page 1

Form 1121
Treasury Department
Internal Revenue Service

United States
Corporation Excess Profits Tax Return
For Calendar Year 1944

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

Excess Profits Tax Computation

Item and Instruction No.	Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1. Excess profits net income (line 18, Schedule A)	\$220,231.43	
2. Specific exemption	\$ 10,000	\$ 10,000
3. Excess profits credit—based on income (line 46, Schedule B)	107,836.60	x x x x x x
6. Total of items 2 to 5	\$117,836.60	\$
7. Difference between item 1 and item 6	\$102,394.83	\$
8. Adjusted excess profits net income (item 7, column 1, or item 7, col. 2, whichever is applicable)		\$102,394.83
20. Item 18 (c) minus item 19		\$
Exemption claimed as set forth in attached rider		
24. Excess profits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)		\$ No Tax

[fol. 118]
We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself, deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

"Jolin E. Brown" 1st V. Pres.
"C. Sasser" Ass't. Treas.
(Corporate Seal)

Subscribed and sworn to before me this 18th day of October, 1945.

"Fred N. Rehm" Notary Public
Expires Jan. 21, 1946
(Notarial Seal)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

M. M. Jensen
Ernst & Ernst

Subscribed and sworn to before me this 18th day of October, 1945.

Esther L. Trout Notary Public
My commission expires May 28, 1946
(Notarial Seal)

Page 2

Questions

- (a) Date of incorporation—July 21, 1916. (b) State or country—Michigan.
- (c) Collector's office in which your income tax return for the taxable year was filed—Detroit.
- (d) Is this a consolidated return? No. If so, procure from the collector Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of the consolidated income tax return.
- (e) In computing the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced by the amount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b)(4) of the Internal Revenue Code? (Answer "yes" or "no")—Yes.
- (f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no")—No.
- (g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no")—No.
- (h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), \$2,517,207.38.
- (i) Has a constructive average base period net income under section 722 been used in computing the excess profits credit used on this return? No.
- (j) Is any unused excess profits credit adjustment computed with the use of a constructive average base period net income? No.

[fol. 119]

Schedule A.—Excess Profits Net Income Computation

Line No.	Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1. Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 38, page 1, Form 1120).....	\$223,355.51	\$.....
7. Total of lines 1 to 6.....	\$223,355.51	\$.....
8. Net gain from sale or exchange of capital assets (item 12 (a) plus item 33, page 1, Form 1120).....	\$ 564.08	\$.....
13. (a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations).....	2,560.00	x x x x x x
15. Total of lines 8 to 14.....	\$ 3,124.08	\$.....
16. Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15).....	\$220,231.43	\$.....
18. Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)...	\$220,231.43	\$.....

[fol. 120]

Schedule B.—Excess Profits Credit—Based on Income.

Page 3

Taxable Years beginning after December 31, 1935,
and before January 1, 1940(If additional columns are required, attach
separate schedule)

Line No.	1. Year Ended Dec. 31, 1936	2. Year Ended Dec. 31, 1937	3. Year Ended Dec. 31, 1938	4. Year Ended Dec. 31, 1939
1. Normal-tax (or special-class) net income—Schedule attached.....	\$69,424.15	\$21,239.38	\$113,620.14	\$ 67,418.97
2. Net capital loss used in computing line 1.....	451.22	2,000.00	423.58	46.25
6. Total of lines 1 to 5.....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
11. Difference between lines 6 and 10.....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
14. Total of lines 11 to 13.....	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
18. Normal-tax (or special-class) net income after applying section 711 (b) (2) (line 14 minus line 17)...	\$68,972.93	\$23,239.38	\$114,043.72	\$ 67,465.22
20. Dividends received credit.....		2,635.43	3,011.89	3,405.95
26. Total of lines 18 to 25.....	\$68,972.93	\$25,874.81	\$117,055.61	\$ 70,871.17
28. Dividends received from domestic corporations.....	\$ 1,250.00	\$ 3,100.50	\$ 3,543.40	\$ 4,007.00
30. Total of lines 27 to 29.....	\$ 1,250.00	\$ 3,100.50	\$ 3,543.40	\$ 4,007.00
31. Excess profits net income (line 26 minus line 30).....	\$70,222.93	\$22,774.31	\$113,512.21	\$ 66,864.17
32. Net aggregate of columns 1, 2, 3, and 4.....				\$132,927.76
33. Increase in lowest year in base period (attach statement).....				121,010.60
34. Total of lines 32 and 33.....				\$253,938.36
35. Average base period net income—General average (line 34 divided by number of months in base period, multiplied by 12).....				\$ 63,484.59
36. Net aggregate of columns 3 and 4, line 31 (see instruction regarding limitation applicable to taxable year ending after May 31, 1940).....			\$180,376.38	
37. Net aggregate of columns 1 and 2, line 31.....			47,448.62	

[fol. 121]

38. Excess of line 36 over line 37.....	\$227,825.00
39. One-half of line 38.....	113,912.50
40. Line 36 plus line 39.....	<u>\$294,288.88</u>
41. Line 40 divided by number of months in second half of base period, multiplied by 12.....	<u>\$147,144.44</u>
42. Average base period net income—Increased earnings in last half of base period (line 41, or the highest excess profits net income for any taxable year in the base period, whichever is lesser) Year 1938.....	<u>\$113,512.21</u>
43. 95 percent of line 35 or line 42, whichever is greater.....	<u>\$190,836.60</u>
46. Excess profits credit—based on income (line 43 plus line 45, if a net capital addition) (or line 43 minus line 45, if a net capital reduction).....	<u>\$107,836.60</u>

Note: Figures in italics appear in red on original.

Automobile Club of Michigan
Detroit, Michigan

Statement Attached To
1944 Corporation Excess Profits Tax Return

The attached 1944 Corporation Excess Profits Tax Return of Automobile Club of Michigan is filed under protest for the reason that the Automobile Club of Michigan believes that it is exempt from income tax under Section 101-9 of the Internal Revenue Code.

Rulings of the Commissioner of Internal Revenue under dates of June 11, 1934, and July 5, 1938, specifically held that the Automobile Club of Michigan was exempt from the imposition of Federal taxes under the provisions of said Section of the Code. Said rulings likewise relieved the Automobile Club of Michigan of liability for filing Federal corporation income tax returns. A letter from Mr. Norman D. Cann, Deputy Commissioner of Internal Revenue, under date of July 16, 1945, purports to revoke the Bureau's rulings aforesaid and directs that the Automobile Club of Michigan file Federal returns for the calendar year 1944. The attached return is filed solely by reason of the receipt of the aforesaid letter and pursuant to its requirements.

The attached corporation excess profits tax return shows the excess profits net income and adjusted excess profits net income received by the Automobile Club of Michigan for the calendar year 1944 and the base period net income of the years 1936 to 1939, inclusive. It does not show any tax computation because the Automobile Club of Michigan [fol. 122] deems that the aforesaid purported revocation is contrary to the provisions of the Internal Revenue Code applicable to the Automobile Club of Michigan. Consequently no tax is being paid herewith.

The attached 1944 return was not filed at the time required by law for the filing of 1944 corporation excess profits tax returns for the reason that on said date there was a ruling of the Commissioner of Internal Revenue in effect, holding that the Automobile Club of Michigan was exempt from taxation under Section 101-9 of the Internal Revenue Code. The attached corporation excess profits tax return is being filed pursuant to instructions, at as early a date following the receipt of the letter of Mr. Norman D. Cann above referred to as possible, since the preparation of this and other returns required by said letter required a substantial amount of time. Delay in filing this corporation excess profits tax return is due to the aforesaid cause and is not due to wilful negligence or intent to evade tax on the part of the Automobile Club of Michigan.

Automobile Club of Michigan
By "John E. Brown"
1st Vice President
By "J. C. Sasser"
Assistant Treasurer

Dated: October 17, 1945

[fol. 123] **Exhibit 21 to Stipulation of Facts—**
Filed August 12, 1944

August 11, 1944

Collector of Internal Revenue,
 Detroit, Michigan

Gentlemen:

We enclose Information Return for the year 1943—
 Treasury Form 990, required under Section 54 (f) of the
 Internal Revenue Code as added by Section 117 of the
 Revenue Act of 1943.

The following supporting schedules are attached:

- Balance Sheet of Dec. 31, 1943.
- Statement of Income for the year 1943.
- Copy of Articles of Association.
- Copy of By-Laws with latest amendments.

Very truly yours,

Assistant Treasurer.

[fol. 124] Form 990

Treasury Department
 Internal Revenue Service

(Revised May 1944)

United States

Annual Return of Organization Exempt from Income Tax
 Under Section 101 of the Internal Revenue Code, or Under

Corresponding Provisions of Prior Revenue Acts

*(Required under Section 54(f) of the Internal Revenue
 Code, as added by Section 117 of the Revenue Act of 1943¹)*

For Calendar Year 1943

Automobile Club of Michigan
 139 Bagley Avenue
 Detroit, Wayne County, Michigan

Have you been advised by Bureau letter of your exemp-
 tion? Yes. If "Yes" state date of letter July 5, 1938.

If "No" application for exemption must accompany this return. Consult collector for your district for information.

State nature of your activities—Automobile club services.

Subsection of section 101 under which you are exempt—9.

This return must be filed on or before the 15th day of the 5th month following the close of the annual accounting period. Return must be filed with the Collector of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

[fol. 125] 1. Have you engaged in any activities which have not previously been reported to the Bureau? No. If so, attach detailed statement.

2. Have any changes not previously reported to the Bureau been made in your articles of incorporation or bylaws or other instruments of similar import? Yes. If so, attach a copy of the amendments.

3. State the names and addresses of the officers or other persons having care of the books of account, minutes, cor-

¹ The filing of a return is not required of any organization exempt from taxation under the provisions of section 101 which is a (1) religious organization exempt under section 101 (6); (2) educational organization exempt under section 101 (6), if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under section 101 (6), if supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) organization exempt under section 101 (6), if operated, supervised or controlled by or in connection with a religious organization exempt under section 101 (6); (5) fraternal beneficiary society, order, or association solely exempt under section 101 (3); or (6) corporation exempt under section 101 (15), if wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such corporation.

response, and other documents and records of the organization.

Dr. James W. Inches, President, St. Clair, Michigan.

Mr. John A. Brown, Vice President, 228 W. Congress, Detroit, Mich.

Mr. J. Lee Barrett, Treasurer, 1005 Stroh Bldg., Detroit, Mich.

Mr. Richard Harfst, General Manager, 1683 Longfellow, Detroit, Mich.

Mr. J. C. Sasser, Assistant Treasurer, 81 Oakdale, Pleasant Ridge, Mich.

Mr. W. F. Arndt, Auditor, 11406 Coyle, Detroit, Mich.

6. Fill in the items on the reverse side of this form, to the extent that they apply to your organization.

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer of the organization for or by which this return is made, each for himself declares under the penalties of perjury that the return has been examined by him and is to the best of his knowledge and belief a true, correct and complete return.

(S) John E. Brown, 1st V. Pres.

(Date) 8/7/44

(S) J. C. Sasser, Assistant Treasurer

(Date) 8/7/44

[Corporate Seal]

The following additional declaration shall be executed by the person other than an officer or employee of the organization actually preparing this return.

[fol. 126] I declare under the penalties of perjury that I prepared this return for the organization(s) named herein and that this return is to the best of my knowledge and belief a true, correct, and complete return.

*Gross Income and Receipts**Item No.*

*1. Receipts from members:		
(a) Dues		\$1,993,695.13
4. Dividends and interest		23 ,531.75
†6. Gross receipts from business activities (state nature):		
(a) Motor News Advertising	\$47,829.50	
		47,829.50
*7. Other gross income and receipts (Miscellaneous)		3,619.30
8. Total gross income and receipts (total of items 1 to 7, inclusive)		\$2,081,675.68

* In all cases where the total of either Items 1, 2, 3, or 7 includes money or property amounting to \$3,000 or more, or to 10 percent or more of Item 8, which was received directly or indirectly from one person, in one or more transactions during the year, itemized schedules showing the total amount received from and the name and address of each such person shall be attached to this return. (The term "person" includes individuals, fiduciaries, partnerships, corporations, associations, and other organizations.) Receipts by a "central" organization from organizations included in a group return need not be itemized in the "central" organization's separate return.

† If any amounts are reported in Items 5 or 6, a classified balance sheet of the organization(s) receiving such amounts, showing the entire assets and liabilities as of the end of the accounting period, should be attached.

A group return on this form may be filed by a central, parent, or like organization for two or more of its chartered, affiliated, or associated local organizations which (a) are subject to its general supervision and examination, (b) are exempt from tax under the same provision of revenue law as the central organization, (c) have authorized it in writing to include them in such return, and (d) have filed with it statements, verified under oath or affirmation, of the information required to be included in this return. Such group return shall be in addition to the separate return of the central organization, but in lieu of separate returns by the

[fol. 127]

Disbursements, Etc.

10. Dues, assessments, per capita taxes, etc., paid to affiliated organizations AAA Dues	52,969.25
12. Wages, salaries, and commissions (other than compensation paid to officers, directors, trustees, etc.)	755,476.60
15. Taxes (such as property, income, social security, unemployment taxes, etc.)	24,834.24
16. Other operating, administrative, and overhead expenses	1,062,108.58
17. Grants, gifts, contributions, etc., paid (state nature):	
(a) American Red Cross	\$5,000.00
(b) Community War Chest	5,600.00
(c) Employees in armed services	1,100.00
	<u>11,700.00</u>
21. Total disbursements, etc. (total of items 9 to 20, inclusive)	\$1,907,688.67

*Automobile Club of Michigan**Statement of Income 1943*

Memberships	1,993,695.13
Motor News Advertising	47,829.50
Interest earned on investment securities	33,646.75
On claim against closed banks	774.15
Dividends received	2,885.00
Gain on disposal of investment securities	1,404.32
Unclassified	1,379.78
Sales of Maps & Guides	61.05
Total	<u>2,081,675.68</u>

local organizations included in the group return. There shall be attached to such group return a schedule showing separately (a) the total number, names and addresses of the local organizations included, and (b) the same information for those not included therein. For further information see regulations under sections 54(f) and 101 of the Internal Revenue Code.

[fol. 128]

Balance Sheet
Automobile Club of Michigan
December 31, 1943

Assets

Cash		\$ 374,167.61
Accounts Receivable:		
Motor News, less reserve of \$1,000.00	\$ 2,176.25	
Detroit Automobile Inter-Insurance Exchange, and Miscellaneous	25,235.96	27,412.21
<i>Other Assets</i>		
Investment securities, less reserve of \$13,000.00 to reduce to quoted market prices	\$1,640,884.91	
Accrued interest, claims against closed banks, and travel advances	9,040.34	1,649,925.25
Property and Equipment		70,609.33
Deferred Charges		8,129.63
		<u>\$2,130,244.03</u>

Liabilities

Accounts payable:		
For expenses	111,454.83	
Salaries and commissions	19,913.48	
Payroll taxes	7,229.02	
Miscellaneous	1,234.57	139,831.90
Deferred Income		894,181.28
Reserve for Post-War Personnel Adjustments		50,000.00
Operating Fund Reserve		1,046,230.85
		<u>\$2,130,244.03</u>

[fol. 129]

May 15, 1945

Collector of Internal Revenue
 Detroit, Michigan

Gentlemen:

We enclose annual return of organization exempt from income tax under section 101 of the Internal Revenue Code. (Form 990 for the calendar year 1944)

We also enclose a copy of our balance sheet as of December 31, 1944 and analysis of item 7 in the statement of income and disbursements.

• Very truly yours,

Assistant Treasurer

cc—Mr. Howard Brown

[fol. 130] Form 990

TREASURY DEPARTMENT
Internal Revenue Service

(Revised May 1944)

United States

Annual Return of Organization Exempt from Income Tax

**Under Section 101 of the Internal Revenue Code, or Under
Corresponding Provisions of Prior Revenue Acts**

*(Required under Section 54(f) of the Internal Revenue
Code, as added by Section 117 of the Revenue Act of 1943¹)*

For Calendar Year 1944

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

¹ The filing of a return is not required of any organization exempt from taxation under the provisions of section 101 which is a (1) religious organization exempt under section 101 (6); (2) educational organization exempt under section 101 (6), if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under section 101 (6), if supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) organization exempt under section 101 (6), if operated, supervised or controlled by or in connection with a religious organization exempt under section 101 (6); (5) fraternal beneficiary society, order, or association solely exempt under section 101 (3); or (6) corporation exempt under section 101 (15); if wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such corporation.

Have you been advised by Bureau letter of your exemption? Yes. If "Yes" state date of letter July 9, 1939. If "No," application for exemption must accompany this return. Consult collector for your district for information.

State nature of your activities—Automobile Club Services
Subsection of section 101 under which you are exempt—9

This return must be filed on or before the 15th day of the 5th month following the close of the annual accounting period. Return must be filed with the Collector of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

[fol. 131] 1. Have you engaged in any activities which have not previously been reported to the Bureau? No. If so, attach detailed statement.

2. Have any changes not previously reported to the Bureau been made in your articles of incorporation or bylaws or other instruments of similar import? No. If so, attach a copy of the amendments.

3. State the names and addresses of the officers or other persons having care of the books of account, minutes, correspondence, and other documents and records of the organization.

Richard Harfst, General Manager, 139 Bagley Avenue, Detroit 26, Mich.

J. C. Sasser, Ass't. Treas., 139 Bagley Avenue, Detroit 26, Mich.

4. Check whether this return was prepared on the cash () or accrual basis (x).

5. This form shall be prepared in accordance with the method of accounting regularly employed in keeping the books of your organization.

6. Fill in the items on the reverse side of this form, to the extent that they apply to your organization.

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the organization for or by which this return is made, each for himself declares under the penalties of perjury that this return has been

examined by him and is to the best of his knowledge and belief a true, correct, and complete return.

John E. Brown, 1st Vice Pres.

(Date) 5/11/45

J. C. Sasser, Asst. Treas.

(Date) 5/11/45

[Corporate Seal]

[fol. 132] The following additional declaration shall be executed by the person other than an officer or employee of the organization actually preparing this return:

I declare under the penalties of perjury that I prepared this return for the organization(s) named herein and that this return is to the best of my knowledge and belief a true, correct, and complete return.

Automobile Club of Michigan
W. F. Arndt

(Date) 5/11/45

[fol. 133]

Gross Income and Receipts

Item No.

*1. Receipts from members:	
(a) Dues	\$2,154,137.70
4. Dividends and interest	42,989.10
†5. Rents	640.00
*7. Other gross income and receipts	61,198.83
8. Total gross income and receipts (total of items 1 to 7 inclusive)	<u>\$2,258,965.63</u>

* In all cases where the total of either Items 1, 2, 3, or 7 includes money or property amounting to \$3,000 or more, or to 10 percent or more of Item 8, which was received directly or indirectly from one person, in one or more transactions during the year, itemized schedules showing the total amount received from and the name and address of each such person shall be attached to this return. (The term "person" includes individuals, fiduciaries, partnerships, corporations, associations, and other organizations.) Receipts by a "central" organization from organizations included in a group

[fol. 134]

Disbursements, Etc.

10.	Dues, assessments, per capita taxes, etc., paid to affiliated organizations	55,776.00
12.	Wages, salaries, and commissions (other than compensation paid to officers, directors, trustees, etc.)	748,805.35
15.	Taxes (such as property, income, social security, unemployment taxes, etc.)	118,024.14
16.	Other operating, administrative, and overhead expenses	1,164,723.28
20.	Other disbursements or charges (state nature):	
	(a) Property and Equipment	\$35,607.03
		35,607.03
21	Total disbursements, etc. (total of items 9 to 20, inclusive)	\$2,122,935.80

Automobile Club of Michigan
1944

Item Number VN

The Crest Co., 5756 Cass Ave., Detroit, Mich.	\$3,030.00
Detroit Auto Inter-Insurance Exchange, 139 Bagley Ave., Detroit, Mich.	3,540.00
R. M. Meisel, Industrial Bank Bldg., Detroit, Mich.	3,540.00
McCann Ericksen Inc., 285 Madison St., New York, N. Y.	4,260.00

return need not be itemized in the "central" organization's separate return.

† If any amounts are reported in Items 5 or 6, a classified balance sheet of the organization(s) receiving such amounts, showing the entire assets and liabilities as of the end of the accounting period, should be attached.

A group return on this form may be filed by a central, parent, or like organization for two or more of its chartered, affiliated, or associated local organizations which (a) are subject to its general supervision and examination, (b) are exempt from tax under the same provision of revenue law as the central organization, (c) have authorized it in writing to include them in such return, and (d) have filed with it statements, verified under oath or affirmation, of the information required to be included in this return. Such group return shall be in addition to the separate return of the central organization, but in lieu of separate returns by the local organizations included in the group return. There shall be attached to such group return a schedule showing separately (a) the total number, names and addresses of the local organizations included, and (b) the same information for those not included therein. For further information see regulations under sections 54(f) and 101 of the Internal Revenue Code.

Item Number XVI

Various adjustments are made through-out the year by reason of joint occupancy and use of premises and facilities, and other adjustments resulting from the sharing of costs and services, which adjustments amounted to \$424,751.99 which if considered, result in a net other operating, administrative, and overhead expenses paid of \$1,164,723.28.

[fol. 135]

Balance Sheet

Automobile Club of Michigan
December 31, 1944*Assets*

Cash		414,876.30
Accounts Receivable:		
Motor News, less reserve of \$1,000.00	2,003.50	
Detroit Automobile Inter-Ins. Exchange and Miscellaneous	28,901.76	30,905.26
<i>Other Assets</i>		
Investment securities, less reserve of \$13,000.00 to reduce to quoted market prices	1,920,689.87	
Accrued interest, claims against closed banks, and travel advances	9,501.85	1,930,191.72
Property and Equipment		100,423.14
Deferred Charges		21,810.96
		<u>2,498,207.38</u>

Liabilities

Accounts payable:		
For expenses	160,578.99	
Salaries and commissions	5,022.95	
Payroll Taxes	7,320.17	
Miscellaneous	1,698.32	174,620.43
Deferred Income		976,115.14
Reserve for Post-War Personnel Adjustments		47,000.00
Operating Fund Reserve		1,300,471.81
		<u>2,498,207.38</u>

(Petitioner's Exhibits 23 and 24 were introduced at Hearing.)

[Vol. 136]

BEFORE THE TAX COURT OF THE
UNITED STATES

EXHIBIT 23

EXHIBIT D

ANALYSIS OF DEFERMENT OF INCOME FROM MEMBERSHIP DUES COLLECTED—PER BOOKS
AUTOMBOLE CLUB OF MICHIGAN

	Year Ended December 31-1943		Year Ended December 31-1944		Year Ended December 31-1945		Year Ended December 31-1946		Year Ended December 31-1947	
Beginning of year:										
Balance—Deferred income account.....	\$ 753,229.15		\$ 888,924.50		\$ 972,917.41		\$1,049,902.85		\$1,194,683.05	
Balance—Collections on memberships issued on a deferred payment basis account.....	6,934.28	\$760,163.43	3,981.30	\$892,905.80	2,867.73	\$ 975,785.14	3,081.10	\$1,052,983.95	4,219.92	\$1,198,902.97
Cash collected on membership dues during the year.....	\$2,146,069.56		\$2,256,745.58		\$2,454,580.01		\$2,772,768.07		\$2,944,825.78	
Less refunds due to cancellations, duplicate payments, etc.....	19,632.06		19,728.54		24,036.04		27,870.42		30,797.02	
Net cash collected on membership dues during the year.....	\$2,126,437.50		\$2,237,017.04		\$2,430,543.97		\$2,744,897.65		\$2,914,028.76	
Portion of membership dues earned during the year.....	1,993,695.13		2,154,137.70		2,353,345.16		2,598,978.63		2,849,504.94	
Excess of net cash collected on membership dues during the year over the portion of membership dues earned during the year.....		132,742.37		82,879.34		77,198.81		145,919.02		64,523.82
End of year:										
Balance—Deferred income account.....	\$ 888,924.50		\$ 972,917.41		\$1,049,902.85		\$1,194,683.05		\$1,263,426.79	
Balance—Collections on memberships issued on a deferred payment basis account.....	3,981.30	\$892,905.80	2,867.73	\$975,785.14	3,081.10	\$1,052,983.95	4,219.92	\$1,198,902.97	—0—	\$1,263,426.79

[fol. 137]

BEFORE THE TAX COURT OF THE
UNITED STATES

EXHIBIT 24

Balance Sheet

Automobile Club of Michigan

June 30-1945

Assets

Cash	\$ 313,336.48
Accounts receivable, less reserve of \$1,000.00	23,691.45
Cash on deposit—reserved for the purchase of investment securities	8,456.89
United States Savings bonds	491,847.90
Other United States Government securities	1,349,599.18
Municipal bonds	56,354.46
Public Utility bonds	162,980.11
Domestic corporation bonds	17,960.62
Domestic corporation stocks	—0—
Reserve to reduce securities to approximate aggregate quoted-market prices	(10,000.00)
Accrued interest on bonds	8,718.50
Miscellaneous accounts and deposits	2,222.50
Land	64,429.64
Buildings	35,554.66
Automobiles and trucks	15,307.48
Reserves for depreciation	(16,518.59)
Deferred charges:	
Premium of pension trust fund for em- ployees	23,329.03
Maps and supplies	—0—
Taxes, insurance, and rent	4,882.37

\$2,552,152.68

[fol. 138]

Liabilities

Accounts payable	\$ 140,241.75
Deferred income:	
Unearned membership dues	1,009,069.50
Collections on memberships issued on a deferred payment basis.....	3,949.57
Reserve for post-war personnel adjustment	47,000.00
Operating fund reserve:	
Balance at January 1, 1945.....	1,300,471.81
Adjustment to surplus reserve.....	9,000.00
Net income for the period from January 1, 1945, to June 30, 1945.....	42,420.05
	<hr/>
	\$2,552,152.68

The operating fund reserve at January 1, 1945, reflects a net charge of \$1,786.61 in connection with the acquisition of other clubs prior to January 1, 1943.

[fols. 139-140] BEFORE THE TAX COURT OF THE
UNITED STATES

RESPONDENT'S EXHIBIT C

Form 872

Duplicate

U. S. Treasury Department
Internal Revenue Service

(Revised June 1947)

Consent Fixing Period of Limitation Upon
Assessment of Income and Profits Tax

C-TS:CenD
JFG:MEN

August 23, 1948

In pursuance of the provisions of existing Internal Revenue Laws Automobile Club of Michigan, a taxpayer (or taxpayers) of 139 Bagley Avenue, Detroit 26, Michigan, and

the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or

on behalf of the above-named taxpayer (or taxpayers) for the taxable year ended December 31, 1943, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1949, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

.....
Taxpayer.¹

Automobile Club of Michigan

Taxpayer.¹

By (Signed) J. G. Vincent, President

(Signed) J. C. Sasser, Assistant Treasurer

(Signed) Geo. J. Schoeneman

Commissioner of Internal Revenue.

By A. D. K.

August 25, 1948

(Date)

[Seal²]

¹ This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

If a consent form is executed by a person acting in a fiduci-

[fols. 141-142] Form 872

Duplicate

U. S. Treasury Department
Internal Revenue Service

(Revised May 1948)

Consent Fixing Period of Limitation Upon
Assessment of Income and Profits Tax

C-TS:NCD

JFG:MEN

19..

In pursuance of the provisions of existing Internal Revenue Laws Automobile Club of Michigan, a taxpayer (or taxpayers) of 139 Bagley Avenue, Detroit 26, Michigan, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year ended December 31, 1943, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1950, except that, if a notice of a

any capacity, such as executor, administrator, or trustee, such person must submit Form 56, "Notice to the Commissioner of Internal Revenue of Fiduciary Relationship," together with certified copy of letters of administration, letters testamentary, trust instruments, or court certificate.

² If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

.....
Taxpayer.¹

Automobile Club of Michigan

Taxpayer.¹

By (Signed) J. Lee Barrett, Treasurer

(Signed) Geo. J. Schoeneman

Commissioner of Internal Revenue.

By A. D. K.

May 23, 1949

(Date)

[Seal²]

¹ This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

If a consent form is executed by a person acting in a fiduciary capacity, such as executor, administrator, or trustee, such person must submit Form 56, "Notice to the Commissioner of Internal Revenue of Fiduciary Relationship," together with certified copy of letters of administration, letters testamentary, trust instruments, or court certificate.

² If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which

[fols. 143-144] BEFORE THE TAX COURT OF THE
UNITED STATES

RESPONDENT'S EXHIBIT D

Form 872

Duplicate

U. S. Treasury Department
Internal Revenue Service

(Revised June 1947)

Consent Fixing Period of Limitation Upon
Assessment of Income and Profits Tax

C-TS:CenD
JFG:MEN

August 23, 1948

In pursuance of the provisions of existing Internal Revenue Laws Automobile Club of Michigan, a taxpayer (or taxpayers) of 139 Bagley Avenue, Detroit 26, Michigan, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year ended December 31, 1944, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1949, except that, if a notice of deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the

the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

Commissioner is prohibited from making an assessment and for sixty days thereafter.

.....
Automobile Club of Michigan

Taxpayer.¹

Taxpayer.¹

By (Signed) J. G. Vincent, President

(Signed) J. C. Sasser, Assistant Treasurer

(Signed) Geo. J. Schoeneman

Commissioner of Internal Revenue.

By A. D. K.

August 25, 1948

(Date)

[Seal²]

¹ This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

If a consent form is executed by a person acting in a fiduciary capacity, such as executor, administrator, or trustee, such person must submit Form 56, "Notice to the Commissioner of Internal Revenue of Fiduciary Relationship," together with certified copy of letters of administration, letters testamentary, trust instruments, or court certificate.

² If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation

[fols. 145-146] Form 872

Duplicate

U. S. Treasury Department
Internal Revenue Service

(Revised May 1948)

Consent Fixing Period of Limitation Upon
Assessment of Income and Profits Tax

C-TS:NCD

JFG:MEN

..... 19..

In pursuance of the provisions of existing Internal Revenue Laws Automobile Club of Michigan, a taxpayer (or taxpayers) of 139 Bagley Avenue, Detroit 26, Michigan, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year ended December 31, 1944, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1950, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the

as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

Commissioner is prohibited from making an assessment and for sixty days thereafter.

.....
Automobile Club of Michigan

Taxpayer.¹

Taxpayer.¹

By (Signed) J. Lee Barrett, Treasurer

(Signed) Geo. J. Schoeneman

Commissioner of Internal Revenue.

By A. D. K.

May 23, 1949

(Date)

[Seal²]

¹ This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

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[fol. 147] BEFORE THE TAX COURT OF THE UNITED STATES

Transcript of Testimony

Court Room No. 859,
Federal Building,
Detroit, Michigan,

September 16, 1952—10:00 a.m.

(Met, pursuant to notice.)

Before: Honorable Graydon G. Withey, Judge.

APPEARANCES: Raymond H. Berry, Esq., 1000 Penobscot Building, Detroit 26, Michigan, A. H. Moorman, Jr., 1708 Industrial Bank Building, Detroit 26, Michigan, appearing for the Petitioner; A. J. Friedman, Esq., Charles S. Gray, Esq., (Honorable Charles W. Davis, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent.

COLLOQUY BETWEEN COURT AND COUNSEL

Mr. Berry:

Now the Automobile Club of Michigan has been exempt from income tax by two specific rulings of the Commissioner of Internal Revenue; the first of which was dated June 11, 1934, exempting the Club from tax under Section 102 of the Revenue Act of 1932, and again on July 5, 1938, under Section 109 of the Revenue Act of '96." I might state—

The Court: What was the last Revenue Act?

Mr. Berry: Section 109, Revenue Act of 1936.

The Court: You said '96. I wondered. You said '96. I wondered if you meant 1896.

Mr. Berry: No, 1936. If I mis-spoke myself, I am sorry. Now, prior to July 16th, 1945, the Club was exempt from income tax for all the years, and on July 16, 1945, the Commissioner, in a letter directed to the Petitioner, revoked his ruling of June 11, 1934 and July 5, 1938, the

two previous exemption letters, and, instructed the Petitioner to file corporation income and excess profits tax returns for the period beginning January 1, 1943. Subsequently these returns were filed and filed under protest.

[fol. 148] Now, it is the Petitioner's position that the Commissioner on July 16, 1945, was without authority in law to attempt to revoke the exemptions theretofore granted to Petitioner retroactive to January 1, 1943. We will not contend as our Petition alleges, that the Petitioner is not subject to tax for the period subsequent to the revocation of its exemption letters, to-wit July 16, 1945. We will admit that for the period subsequent to July 16, 1945, that we are taxable. We contend that the Commissioner acted arbitrarily and without authority in revoking our letters of exemption by his letter of July 16, 1945, and determining a deficiency in tax for any period prior thereto.

We have another legal point involving the statute of limitations. The Petitioner contends that Respondent is barred from asserting any tax for the years 1943 and 1944 because of the running of the statute of limitations against those years. Petitioner filed Form 990, in compliance with regulations of the Commissioner, for each of those years, that is in 1943 and 1944, as required by Section 54 (f) of the Internal Revenue Code. Petitioner further contends that those returns were returns for the purpose of starting the running of the statute of limitations under Section 275 of the Code. Now as a matter of fact Form 990 was filed for all the years involved and for years prior thereto.

I failed to state that we have by stipulation agreed upon many facts and points involved as matters involved in this proceeding, and that later the stipulation will be offered into evidence. These forms 990 for the years 1943 and 1944 are part of the stipulation.

Petitioner also contends that—well, it is apparent that Petitioner will become taxable for the first time on January 1, 1943, or later depending upon the decision of this Court. The question arises as to what is the proper basis for computing the deduction for depreciation on Petitioner's property beginning with the date Petitioner becomes taxable. It is our position that for such years it may be taxable and entitled to depreciation deductions on the

basis of the unadjusted cost of property in its possession at the date when it attains taxable status. We cite as ample authority, the published ruling of the Commissioner, GCM [fol. 149] 40857 for that position. We contend, the Respondent contends that Petitioner is only entitled to deduction of depreciation on the basis of cost less depreciation.

The Court: To make your position clear, will you be a little bit more specific with respect to what you mean by unadjusted cost?

Mr. Berry: I might state that it has been the policy of the taxpayer as it acquired furniture, fixtures, office equipment and other forms of personal property, to charge off the cost of those properties as acquired. In other words, they acquire a desk in 1938 or 1940 or at some other period of time, then they would immediately expense that out. It made no difference to them because there wasn't any tax involved and they considered that for conservative bookkeeping and their own financial statements that was the proper way to do it.

Now, in the alternative, we contend that the depreciated basis is the original cost unadjusted. It is recognized that the Court may determine that the proper basis of depreciation is the fair market value of the date the Petitioner became taxable. Now, this is an analogy to the situation we find taxpayers found themselves in on March 1, 1913. Bear in mind heretofore the Petitioner was exempt from tax. Now we come into a period of taxable status whenever the Court may find that to be, or if you agree with us that it is not until after July 16, 1945, then the question is raised as to whether or not we are entitled to use the fair market value for depreciation.

For the period here involved, well Petitioner received by far its greater amount of revenue from the dues of its members. For the period here involved these dues were at the rate of \$10.00 except from October 1, 1946, when it was raised to \$12.00. Now these dues are paid in advance and entitled the member to all the services offered by the Club for a period of twelve months thereafter. These dues are not collected on a calendar year basis. For instance, a person may join the Club in December. We contend he is entitled to twelve months' service for his \$10.00

or \$12.00 as the case may be, under it for the year that is applicable. Now Petitioner has regularly treated these [fol. 150] dues as unearned income at the time received, has taken them into account and prorated over the twelve months' period, so it is he in effect purchased his membership. It is our position that this is the proper method of accounting and best reflects the income of the Petitioner.

Petitioner contends that the Commissioner is without authority to change the method of accounting or book-keeping regularly employed by the Petitioner in the absence of proof that such method does not clearly reflect Petitioner's income. That has been the method employed by the Petitioner all through the years here involved whether it is '43, '45 through '47. It is Respondent's position that upon the receipt of the dues, the entire amount should be taken into income. In other words, that \$10.00 received in December should be taken into the account and put in the income for that year. Even assuming that the Respondent is correct in his treatment of these dues, he was in error as to the correct amount in his notice of deficiency, the correct amount is reflected in the stipulation.

Now, based upon the decision of this Court, and the various issues involved, Petitioner may be entitled to a net operating loss carry-back from either or both of the years 1946 and 1947. Respondent in his notice of deficiency failed to allow any net operating loss deduction in either or both of the years 1944 or 1945. A 1946 carryback as you know, would be carried back to '44, and 1947 back to 1945.

Now, as to the excess profits tax credit, we claim that the amount of the unused excess profit credit for the year 1945 carries back to 1943, and the unused excess profit *profit* credit for the year 1946 to the year 1944. Of course the amount of the carry-back credit which Petitioner will be entitled is dependent upon the decision of the Court on the issues involved in this case.

Mr. Friedman: All right. The Commissioner in 1945 was confronted by this situation: There are a number of clubs similar to the Automobile Club of Michigan. Up to [fol. 151] 1943 the Commissioner having inquired into the

taxability or the exempt status of these clubs that had, as this one had been, exempt, by ruling of the Commissioner, not as a matter of law, but by ruling of the Commissioner that they had theretofore invoked the tax exempt status, that is, they were not required to file income tax returns or pay the income taxes that a corporation ordinarily would be required to pay. As a result of a tremendous amount of litigation in this court as well as other courts, and I believe the Supreme Court, too, it was ruled prior to 1943 that automobile clubs similar to the Automobile Club, Petitioner in this case, that they were taxable, that when the Commissioner first commenced making his rulings that these clubs were exempt, the conditions then had changed in the interim, that in the period from when he had made the rulings up to 1943. Now, on brief the Respondent will point out these cases, cite them, and it was the position of the Commission that all Automobile Clubs were to be given like treatment with regard to their income tax liability. In 1945 the Commissioner acting in this case as he had acted in other cases similar to this inquired of the Petitioner as *it is* status, its operations and other material facts which would permit him to determine whether this club came in the same category as the others, and after taking the matter under consideration and having received the return of the questionnaire, he saw no reason why this Petitioner should be given different treatment than other automobile clubs, and accordingly taxed them on the basis that he taxed the other clubs, that is, he ruled that they were taxable as of January 1, 1943.

The Petitioner filed returns. I should say at this point that they filed federal corporate income tax returns and excess profits tax returns in October of 1945. Those returns were for the taxable years ended December 31, 1943 and 1944. The stipulation of facts contains an accompanying letter in which Mr. Berry stated to the Commissioner that he was filing those returns under protest. They didn't go along with this ruling of the Commissioner.

Now, since Mr. Berry has conceded the taxability of the Petitioner from July 16, 1945, onward, and it is presumed [fol. 152] that he also would concede that the Petitioner was taxable as of January 1, 1943, were it not for the fact

that as he claims or the Petitioner claims the letter was sent retroactively. So far as that issue was concerned, I believe the Respondent would leave it rest there and take up the question of retroactive effect of that letter on brief.

The Court: What is the significance of the date July 16th?

Mr. Friedman: That is the date on which the Commissioner sent a letter to the Petitioner informing the Petitioner that because of rulings which the Commissioner had made, and because of decisions in other automobile club cases, in the taxing of automobile clubs throughout the country as of January 1, 1943, that he was revoking his rulings which he had theretofore made in 1934 and 1938, that he was revoking those rulings and putting them in a taxable status as of January 1, 1943. That is the letter which is dated July 16, 1945.

The Court: I see.

Mr. Friedman: Now in the amended petition—and I believe at this point perhaps—I just noticed it, perhaps the Court might like to change the caption of the amended petition. It reads, "Automobile Court of Michigan." That is probably a typographical error.

Mr. Berry: If it says anything other than Automobile Club of Michigan, it is in error. It should be Automobile Club of Michigan.

The Court: It may be amended to read Automobile Club of Michigan.

Mr. Berry: Let's see that. Just a moment. Mine says "Club."

The Court: Well, this as filed says, "Court."

Mr. Berry: One says "Club" and one says "Court." It should be Automobile Club.

Mr. Friedman: Now, the amended petition puts in issue the question of, the same issues that the original petition did, but in addition it puts in issue the question of the proper deduction of amortizing the cost of the leasehold interest on their headquarters, club headquarters office at 139 Bagley, and perhaps we should dispose of that right [fol. 153] away. The amended petition alleges that the Petitioner paid on April 12, 19—

Mr. Berry: —'26.

Mr. Friedman: — '26, a consideration of \$750,000.00. No, I beg your pardon, \$275,000.00. Was it two hundred seventy-five?

Mr. Berry: Two hundred seventy-five.

Mr. Friedman: \$275,000.00 for a leasehold interest the term of which was originally 99 years commencing on July 1, 1916, and at the time that they acquired it in 1926 it had an unexpired term of ten years' lease or 89 years, and that prior to 1941, again we come back to this, January 1, 1943, rather, and again that is the year in which these Acts began that they had not capitalized this asset on their books, but they had written it off, expensed it in other words. But they take the position in the amended petition that they did that improperly, that while it might have been fairly good accounting practice, it didn't square up with income tax law, and now they want to restore the value of that leasehold interest as an asset and amortize it over a period of years, and the amended petition states that the fair market value of that leasehold interest as of January 1, 1943 was \$750,000.00. We have eliminated that issue out of the case by a stipulation of facts, and the court when it gets the stipulation of facts, and the amended petition will note that that particular issue was set forth in paragraph 5-i of the amended petition. It has been eliminated as an issue by paragraph 23 of the stipulation. In other words, that particular issue has been settled by the parties as evidenced by paragraph 23 of the stipulation.

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Mr. Berry: Your Honor, I believe Mr. Friedman stated, I would like to see if I understood the statement correctly, that in the Commissioner's letter of July 16, 1945, except it be in the stipulation, referred to other clubs. The only reference in that letter of July 16, 1945, to any other organization is contained the first paragraph which I read as follows. This is from the Commissioner of Internal Revenue to the Automobile Club of Michigan and it is from the letter of July 16, 1945.

[fol. 154] The Court: Mr. Berry, is it necessary to read that in the record?

Mr. Berry: No, I am not going to read the letter. The

first paragraph, three lines, will explain my position. "Reference is made to the information submitted by you for use in determining your status for federal income tax purposes. In view of the opinion expressed in GCM-23688, cumulative bulletin 1943, page 283." Now, that is the reference to the American Automobile Association, an association of automobile clubs. Based on that, the opinion that he rendered in connection with the American Automobile Association case, he therefore holds in this letter that the Automobile Club of Michigan is taxable. Now, it is quite true that subsequent and in 1945 the Commissioner did proceed against other clubs similarly to the proceeding here. Now, if the Court should find that we are entitled to depreciate our assets on the basis of the fair market value of same, as at the date we became taxable, it will be necessary for the Court to have in its records the fair market value of those assets. Now, a stipulation has been prepared by Respondent to which Petitioner will agree and which is in the hands of the government.

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Mr. Friedman: * * * we did for the convenience of both parties and to the Court send our Revenue Agent Engineer over to the Petitioner's office and through a lot of work, and only for the purpose of convenience and not for the purpose of in any way consenting to their idea of fair market value, we have arrived at figures of fair market value of assets depreciable, assets of January 1, 1943, and these are as follows: Buildings \$35,550.00.

Mr. Berry: Wait a minute. Okay.

Mr. Friedman: Office furniture and fixtures, \$105,000.00. Leasehold improvements, \$103,730.00. Building alterations, \$25,780.00. Automobiles and trucks, \$12,530.00. * * *

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Mr. Berry: Your Honor, I will call Mr. Matheson. Take the witness stand, please.

Whereupon,

[fol. 155] MATHESON, EDMUND S., called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and your address for the record.

The Witness: Edward S. Matheson, the address, business address 139 Bagley, City of Detroit.

Direct Examination.

By Mr. Berry:

Q. Mr. Matheson, will you state what your business connection is.

A. I am the General Manager of the Automobile Club of Michigan.

Q. And how long have you been General Manager of the Automobile Club of Michigan?

A. For the past seven months.

Q. Prior to that time what was your employment?

A. The assistant general manager.

Q. Of the Automobile Club of Michigan?

A. For five years.

Q. How long have you been employed by the Automobile Club of Michigan?

A. Thirty-two years this coming December.

Q. What have been some of the positions you have held in connection with the Club?

A. For 28 years Manager of the Travel Department, and then the Assistant Managership job of the Club.

Q. Are you familiar, you are familiar with the fact that the litigation here involved involves the years 1943 through 1947?

A. I am.

Q. Aside from any legal arguments as to whether or not it is legal, were you familiar with the operations of the Automobile Club of Michigan during those years?

A. Quite extensively from a view of the operations.

Q. Would you state as brief - - as you can some of the functions or the purposes for which the Automobile Club was organized and its functions?

[fol. 156] A. Well, as a business organization we devote most of our resources and efforts to the bettering of the general conditions for motorists and the promotion of proper laws relating to the use of the motor car, especially the use that our members put it to, the promotion of travel both interstate, within the state, and intrastate, national and international in all its phases, and the use of the automobile for other modes of transportation. We have been engaged in the promotion of safety and traffic problems on a local and state-wide scale and also nationally. We devote considerable time to the promotion of school boy patrols. We organized the school boy patrols in the State of Michigan. Our plan has been adopted on a national scale.

Q. Just how does that operate?

A. We organize these patrols in the schools of the State. We furnished text books to the teachers and to the schools, of course, as to the proper conduct of how these patrols should operate, and as a reward to the patrol boys we take them to, some of them to Washington annually to interest them in further promoting the safety of guiding children back and forth across busy intersections on the way to school. We have also conducted seminars in the University of Michigan annually — which we promote the education of the school teachers in the state to the driver training courses which have been, have become very popular in recent years. Our safety and traffic department and engineer department also makes traffic surveys through the State of Michigan at the request of various cities and communities, and many of our proposals have been adopted by these cities from a safety standpoint. We supply our members both here in Michigan and those affiliated with the Three A with emergency road service in which we come to the aid of people in distress, that is their cars are disabled. We publish a monthly magazine that contains news of travel, of laws as it pertains to the use of cars. That magazine goes to every member of the Club, every active member of the Club. In the travel activity we supply maps, log highways throughout the country, throughout North America. We advise the tourists as to the conditions which they will encounter. We assist the American Automobile [fol. 157] Association in its appointments of proper places

to be housed and be fed; in the realm of international travel we secure reservations for our members when traveling abroad; we ship their cars to European ports at the present time, and will to Asia very shortly. In all we attempt to do for the motorist in the collective way that which he is unable to do as an individual.

Q. Mr. Matheson, somewhere in some of these papers is a reference to sign-boarding or signing, or some symbol to designate traffic ordinances or something.

A. We promote the proper signing of city streets and highways throughout the country. In the early days of the Club it was necessary for us to provide signs to be placed on the city streets and on many of the highways.

Q. You are referring now to these stop signs?

A. Stop street signs and directional signs.

Q. Directional signs. You say the Club furnished those?

A. Oh, yes.

Q. Gratis to the community?

A. Gratis to the community.

Q. In these various activities is there any attempt to make a profit in connection with those services you render, that is in competition with commerce or business?

A. None whatsoever.

Q. Does the Club have any capital stock?

A. None whatsoever.

Q. Has the Club ever paid any dividend?

A. None whatsoever.

Mr. Berry: That is all I have. Mr. Friedman.

Cross-examination.

By Mr. Friedman:

Q. The Club maintains regular commercial bank accounts throughout the period from 1943 to 1947, I presume?

A. That's right.

Q. And are you familiar with the way the bank accounts were kept?

A. No, I am not, not during those particular years.

[fol. 158] Q. Are you familiar with the number of bank accounts which were maintained during those years?

A. I can't say for sure that I am. I would assume that I know, but I wouldn't want to give a specific figure on that.

Mr. Friedman: That is all.

Mr. Berry: I have no further questions.

(Witness excused.)

Mr. Berry: Your Honor, at this point we have two other witnesses. I would like my partner and associate, Mr. Moorman, to have the privilege of examining the witnesses.

Mr. Moorman: The Petitioner calls Mr. J. C. Sasser.

Whereupon,

SASSER, JOSEPH C., called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address for the record, Mr. Witness?

The Witness: Joseph C. Sasser. Business address, 139 Bagley, Detroit.

Direct Examination.

By Mr. Moorman:

Q. Mr. Sasser, are you employed by the Automobile Club of Michigan?

A. I am.

Q. How long have you been so employed?

A. Since June 30, 1924.

Q. What position do you now hold at the Club?

A. I am Assistant Treasurer, I am also Controller and Assistant General Manager.

Q. How long have you been Assistant Treasurer, Mr. Sasser?

A. Since June 30, 1924.

Q. Are Petitioner's books and records in your custody?

A. They are.

Q. Are Petitioner's books kept in accordance with your instructions?

[fol. 159] A. They are.

Q. You are the chief accounting officer for the Petitioner?

A. I am.

Q. On what method of accounting does the Automobile Club keep its records?

A. They are kept on the accrual method.

Q. To your knowledge, how long has the Petitioner's books been kept on this method?

A. Ever since I have been with the Club.

Q. Are you familiar with the manner in which the Petitioner's books reflect the receipt of dues?

A. I am.

Q. Joint Exhibit 10 is a balance sheet, the balance sheet figures of Petitioner for the years commencing December 31, 1942 through December 31, 1947. I have a copy of such exhibit.

Mr. Friedman: Oh, yes, this is the stipulated Exhibit Number 10?

Mr. Moorman: That's right.

Mr. Friedman: Sure, I have it.

Q. (By Mr. Moorman): Mr. Sasser, I hand you Exhibit 10 which contains the balance sheets of the Club as of December 31, for each year from 1942 through 1947. Will you describe how membership dues appear on the balance sheets during the period 1942 to 1947 inclusive?

A. Will you ask that question again, please, Mr. Moorman?

Q. Will you describe how membership dues appear on the balance sheet during the period 1942 to 1947 inclusive?

A. The second item under the liabilities side of the balance sheet is an item of unearned membership dues. That is the liability, that is exactly what it states. This is unearned membership dues, in other words, dues paid in advance.

Q. How does the exhibit, describe how dues are taken into income after being credited to the unearned income liability account?

A. I would like to illustrate that with one membership. A \$10.00 membership is received, it is credited.

[fol. 160] Mr. Friedman: Just a minute. Might I interrupt there and ask the witness whether when he said a \$10.00

membership, does he mean \$10.00 cash is received as dues in payment of a membership, is that-what you mean?

The Witness: Right, right.

Mr. Friedman: That would be better if he stated that, I think.

Mr. Moorman: He is using this as an illustration.

The Court: He has so stated now. Proceed.

The Witness: When \$10.00 cash is received for a membership it is credited to the unearned dues account. In the first month of that membership one-twelfth of that membership is credited to membership income. In other words, we accrue one-twelfth of the membership per month, one-twelfth of all memberships in the month that are in force. Does that answer your question?

The Court: Witness, when you do so what appears on your balance sheet?

The Witness: What appears on the balance sheet would be the total amount of unearned dues that have not been taken into the membership income account.

The Court: How are dues which have been taken into the income designated on the balance sheet?

The Witness: They are designated by the final result of this unearned membership dues, dues which were taken into the account would be reflected in what we call the operating statement of income and expenses.

The Court: Proceed.

Mr. Moorman: Joint exhibit in the stipulation, Exhibit 9, the balance sheets of the Petitioner from December 31, 1934 through December 31, 1941.

Mr. Friedman: I got it.

Q. (By Mr. Moorman): Mr. Sasser, I hand you Joint Exhibit Number 9 and ask you, have the accounts of the Petitioner since 1934 which is the earliest year we have the records in evidence in this proceeding, have the accounts of the Petitioner since 1934 reflected as deferred income the unearned portion of membership dues?

A. They have.

[fol. 161] Q. Why did you approve and adopt this method of accounting for membership dues?

A. Because I think that that is the only sensible way

to conduct a business of this kind. By that I mean if you collect dues in advance, you are not entitled, should not be entitled to use just any and all, any part of that amount, which you might collect this month which should be spread over a period of twelve months. That is what the \$10.00 dues is paid for, to cover a period of twelve months.

Q. If there any other reason that, in your opinion, makes this method of accounting the proper method, for example, refunds?

A. Well, it has been the policy of the Automobile Club of Michigan to make refunds for unused or unearned portions of the membership as long as I have been with the Club, and that is just in my mind a matter of what is right and proper. If all of the membership has not been used, we will refund the unused part of it.

Q. Well, was this the policy of the Club during the taxable years that are involved in this proceeding?

A. It was.

Q. As I understand it, your testimony is that that has been the policy of the Club since your association with the Club?

A. It has.

Mr. Moorman: Does the Court—may I have this?

Q. (By Mr. Moorman): I hand you again Joint Exhibit 10 which is the balance sheet of Petitioner from 1942 to 1947, and I ask you, Mr. Sasser, were you requested by me to compare the figures contained on this exhibit with the books of the Petitioner?

A. I was.

Q. And have you done so?

A. I have.

Q. And do the balance sheet figures correctly reflect the figures as they appear on the Petitioner's books?

A. They do.

I have no further questions.

Mr. Friedman: Are you through?

Mr. Moorman: Yes.

[fol. 162]

Cross Examination.

By Mr. Friedman:

Q. Mr. Sasser, when you collected the \$10.00 in cash from a member for his membership dues in the years in which \$10.00 was the amount of the membership before it was changed to \$12.00, how did you apply the \$10.00? Let me ask you this further question to straighten you out on that. Did you take a part of the \$10.00 and allocate it for the magazine which the Club calls "The Motor News"?

A. There is \$1.00 set aside for that account, yes.

Q. So that leaves you \$9.00 for other membership, for dues, for other membership functions, is that right?

A. That's right.

Q. And how much did you pay to a salesman or any other person or whatever his name might be known for soliciting that member to pay his dues?

A. What is the Commission or membership, the commission on membership sales, is that your question?

Q. Well, all right, call it that way.

A. The commission is \$2.50 for a new membership.

Q. Now, that is \$7.00?

A. I beg your pardon?

Q. That is \$7.00?

The Court: That is \$6.50.

Q. (By Mr. Friedman): How much did you say it was?

A. \$2.50 on a new membership.

Q. That is the commission?

A. Yes.

Q. All right, and a dollar allocated to the Motor News. That is \$6.50 left, isn't it, is that right?

A. That's right.

Q. Now, is it your idea that if a member resigned from his membership, that he would be entitled to a refund, is that your idea?

A. That's right.

Q. In making the refund, did you refund him any part of the \$1.00 which was allocated or set aside for the Motor News?

A. We refunded on a pro-rata basis, and the basis was \$10.00. We refunded on the basis of \$10.00.

[fol. 163] Q. Now, now just answer the question.

Mr. Moorman: The witness—pardon me—the witness is attempting to answer the question Mr. Friedman asked. Will you let him come to the conclusion?

Q. (By Mr. Friedman): All right. Now, you said you refunded on a pro-rata basis, and what is the basis of that making that pro-rata, what items did you take into account?

A. As an illustration, if a membership had six months to run, we refunded \$5.00.

Q. Now, how did you arrive at the \$5.00?

A. Because it was one-half of a year, one-half of a year to run, and simply took one-half of the membership fee, the yearly membership.

Q. Although you paid the salesman \$2.50 for soliciting his membership, right?

A. That's right.

Q. You paid or set aside for the Motor News \$1.00?

A. That's right.

Q. Right, and you were left with \$6.50 for—

A. That's right.

Q. Payment for that member for finances other than The Motor News?

A. That's right.

Q. Would the salesman pay back any part of his \$2.50?

A. Not if it had run for six months, make no deduction from the salesman.

Q. What if it ran for less than six months?

A. I don't know. I don't remember any iron-bound rule for that. If the membership was cancelled, say, and it had not run over 30 days there would be a deduction.

Q. Do you have Exhibit Number 2 with you? I'll show you Exhibit 2, and ask you whether you know that those are the by-laws of the Club which existed and were in effect during all the years and during all the time up until March 15, 1947?

A. I know that.

Q. Now, point out in those by-laws any provision where there was required of you to refund dues to a member in the case he resigned?

[fol. 164] A. There isn't.

Q. There isn't any. As a matter of fact, there are provisions in those by-laws which required the member to pay up more dues in the event he left the organization for some reason or other, isn't there?

A. Would you point that out to me? I don't understand just what you are referring to?

Q. Withdraw that question for a moment. Let me refer you to Section 5 of Article Number 10 found on page 13 of Exhibit 2. "Any member who is in good standing not in arrears or indebted to the Club against whom no charges are pending may resign his membership by delivering a notice thereof to the Secretary who shall report the name—pardon—the same at the next meeting of the Board of Directors, and upon resigning such member shall forfeit all his rights and interest in the Club property and assets." That was one of your by-law provisions, was it not?

A. Yes, sir.

Q. Let me read you Section 10. "Any members whose annual dues remain unpaid for 30 days, after receiving notice from the Club Treasurer that they are due, shall stand suspended from all privileges of the Club. He shall be notified by the Treasurer of his suspension and if he shall fail to pay such dues within 30 days after such notification or suspension he shall cease to be a member of the Club, but he shall not thereby be relieved from payment of the dues and shall be held for the payments of the dues after two months' dues and the expense of collecting the same." So rather than you in your by-laws having any provision for refunding dues to members, we find provision in there, do we not, for actually collecting dues for members, isn't that a fact?

A. What you read there is true.

Q. All right. Now, during the years 1943 through 1947 the Club, Petitioner in this case, maintained certain bank accounts in the City of Detroit?

A. That's right.

Q. How many bank accounts did they maintain?

A. There is the National Bank of Detroit, the Detroit Bank, the Manufacturers Bank, the Industrial Bank.

[fol. 165] Q. Yes, and into what account was the items stated in your income account as it is shown on it, on your

ledger, in what account was the receipts received indicating that account, and — what account were they deposited?

A. National Bank of Detroit.

Q. That is, the various items mentioned in your income account were deposited into the National Bank of Detroit?

A. That's right.

Q. Into one general account?

A. That's right.

Q. Are you sure about that, that there was one general account into which all items of receipt indicated in your income account were deposited during that time?

A. All receipts go into the National Bank of Detroit first. We have two accounts in the National Bank of Detroit. Now, if it is in the investment account, the collection of interest, return on investment, it is put into that investment account.

Q. All right, so that the situation is this: All receipts of the Petitioner were deposited into one general account, is that right?

A. That's right.

Q. And those deposits, those receipts include membership dues?

A. That's right.

Q. That's right. There was no attempt in the account to segregate membership dues from any of the other items of income, is that right?

A. No.

Q. Is that correct, Mr. Sasser?

A. That's right.

Q. That at certain times the governing body of the Petitioner, what is it, a board of directors?

A. Yes.

Q. The Board of Directors decided to allocate from the account certain amounts of money to be used for investment purposes by the Petitioner?

A. Right.

[fol. 166] Q. That is, if they noted that a certain security or certain property was proper to be invested in, they wanted to have the funds available to make the investment, is that right?

A. Yes.

Q. And for that purpose they opened a separate account which you now term as an investment account?

A. That's right.

Q. And this money which was intended to be used for investment purposes was put into the investment account, is that right, transferred to the investment account?

A. That's right. The investment account is really, the purpose of that investment account is as collections are made, interest collections, they are all paid to the National Bank of Detroit, they are put into that account.

Q. Now when you say that the company has always used the accrual method of accounting, did you read paragraph Number 25, 25 of the stipulation of facts, Mr. Sasser?

A. No, sir.

Q. Is it not a fact that before December 31, 1936, the furniture, fixtures, and office equipment, building improvements were recorded as assets in the accounts of the books of the company?

A. I don't remember the date, but I think that is correct. I know they were at one time. I don't remember just what year.

Q. Yes, and on December 31, 1936 the entire remaining assets appearing on the books of the company except automobile and automobile trucks were charged as an expense?

A. That's right.

Q. And thereafter again with the exception of automobiles and automobile trucks, as you acquired any property, the cost of the property was taken as an expense?

A. That's right.

Q. Do you consider that keeping your books on an accrual method of accounting?

A. Maybe not that particular feature of it.

Mr. Friedman: That is all.

[fol. 167] Re-direct Examination.

By Mr. Moorman:

Q. Mr. Sasser, you did testify on direct examination that it has been the policy of the Automobile Club of Michigan since your association with the Club to refund the unearned

portion of membership dues at a time of a member's resignation, death or termination for any other reason?

A. That is true.

Q. Attached to the stipulation of facts as Joint Exhibit 2-A—

Mr. Moorman: Is that the by-laws amended?

Mr. Friedman: Yes.

Q. (By Mr. Moorman)—are the by-laws of the Automobile Club of Michigan as effective March 15, 1947, and I hand you this exhibit, Mr. Sasser, and ask you to read Article 12. Would you read it for the record, please?

A. Aloud?

Q. Please.

A. "Article 12. Termination of membership. Section 1. The privilege of membership shall be terminated by death, by resignation, by non-payment of dues as outlined in Article 11, or upon other reasonable cause by ten days' notice in writing from the office of the Secretary or upon order of the Board of directors, such notice of termination to be accompanied by check for the unused portion of the annual dues, as determined by the Board of Directors."

Q. Now, is this the policy that you were testifying to, the Club—

A. That is true.

Q. Mr. Sasser, just so there will be no doubt as to the treatment of receipt of membership dues, I would like to ask you what would be the amount of the refund if a membership was terminated at the end of one month, and we will assume the figure of \$12.00 as being the cost of the membership?

A. Terminated at the end of one month?

Q. That's right.

A. If we paid a commission on it, we would deduct \$2.50. [fol. 168] Q. No, I asked you what would be the amount of the refund to the member if he cancelled, terminated his membership at the end of one month?

A. It would be \$10.00 less 83⅓ cents.

Q. What is the explanation for the 83 cents?

A. Because there were 12 months in a year, and—

Q. We were assuming that the membership, the cost of

the membership was \$12.00 just for purposes of explanation?

A. It would be a refund of \$11.00.

Q. And what would be the amount of the refund at the end of the second month if membership was terminated?

A. \$10.00.

Q. So that the Commission expense that might be involved, and any other feature of expense in connection with securing of a membership would not be retained but would be returned as part of the refund to the member if he resigned?

A. I can't give you an iron-bound rule for that. I just know if a membership is cancelled shortly after it is taken out, if we have paid a commission on it, we deduct the commission that is paid on it. If it has run for any time, two, three, four months, it is refunded strictly on pro-rata basis.

The Court: May I see this exhibit, please, that he is looking at? What paragraph was that now? Proceed.

Q. (By Mr. Moorman): Associate counsel wants to be sure that I ask the question, was the making of refunds of membership dues an established policy of the Club during the period of your association with the Club?

A. Ever since I have been with the Club.

Q. Mr. Sasser, on cross examination you were asked if the Club segregated its funds; may I ask you, at this time is it necessary for the Club to segregate its funds to be in a position to determine its liability for any unearned membership refund?

Mr. Friedman: I object to that, your Honor. I think that is a question that this witness is incompetent to answer, and it doesn't make any difference anyhow. The fact is they didn't make any segregation.

[fol. 169] The Court: Well,——

Mr. Moorman: The question is of this witness, was it necessary to make a segregation to know the liability of the Club for unearned membership dues?

The Court: You are asking an accounting question. The witness is an accountant. I think we will take the answer. Will you answer that?

The Witness: Now, will you ask the question again, please?

Q. (By Mr. Moorman): Is it necessary for the Automobile Club of Michigan to segregate any funds in order to determine its liability for unearned membership dues?

A. By segregating, do you mean setting aside in a certain bank account?

Q. That is what I mean.

A. No, it is not.

Q. It is not?

A. No.

Q. In cross examination you were asked, as I recall it, the question, did the books of the Automobile Club of Michigan reflect that capital investment in certain depreciable assets that either may have been set on the books, the depreciation account, or expensed. Do you recall being asked that question?

A. Yes.

Q. Mr. Sasser, at any time prior to the revocation of the tax exemption that was given to the Automobile Club by the Commissioner of Internal Revenue, did it make any difference whether expenditures for depreciable assets were expensed or reflected on the books in the depreciation reserve?

A. Did it make any difference?

Q. Did it make any difference to the Automobile Club?

A. Well, it did not tax-wise because we did not have a tax situation.

Q. What did you mean when you said it did not make any difference tax-wise?

A. We weren't taxable. We didn't have that problem to consider.

[fols. 170-171] Q. You mean you did not have the problem of depreciation because there was no income tax?

A. That's right.

Q. Mr. Sasser, on the matter of refunds once more, would you tell the Court of the instance of the lowest refund that the Club made, to your knowledge?

A. Well, the lowest one we could possibly make would be 84 cents. That would be for one month.

Q. Did you actually make such a refund?

A. Yes, sir.

Mr. Moorman: Thank you.

Re-cross Examination.

By Mr. Friedman:

Q. About how many of those types of refunds did you make, 84 cents?

A. Well, surely not many, not many, Mr. Friedman, but I know we have made them.

Q. Well, don't you have to strain your memory a bit to recall refunds of any kind?

A. No, I don't, because I have signed many many of the checks.

Q. Well, how many members have you got, how many members did you have in 1945, let's say?

Mr. Moorman: That is stipulated. Do you want to refresh the witness's memory?

The Witness: I don't have the actual figure in mind.

Q. (By Mr. Friedman): In 1945 243,630 members. How many refund checks did you sign in 1945?

A. I do not have the information at this time.

Q. And in 1945 you received in cash on account of membership dues \$2,435,043.97. How many dollars of that money did you refund on account of resignation of members or refunds did you make in 1945?

A. I do not have those figures with me, Mr. Friedman.
[fol. 172] The Court: Witness, I am still a little bit hazy about this business of refund. Now, Article 12, Section 1, which you read in the record, indicates that the question of amount of refund is up to the Board of Directors. Now, does the Board of Directors as a matter of practice pass on each refund?

The Witness: No, sir.

The Court: Well, then, has the Board of Directors, to your knowledge, in its minutes a resolution passing generally from time to time upon the amount of refund to be made or adopting a formula from which you as accountant could figure a refund?

The Witness: Not to my knowledge. I can only say the Board of Directors has been thoroughly familiar with our method of refunds.

The Court: Well, then, just what did the Board of Di-

rectors have to do with determining the unused portion of the annual dues, or did they have anything to do with it?

The Witness: Well, the Board of Directors adopted those by-laws, and,—

The Court: Who did determine how much of the refund was to be made in each instance?

The Witness: I can only say that it had been a well-known policy with the management of the Club ever since I have been with the Club.

The Court: Well, you are not responsive to the question. I say, who determines how much of a refund is to be made in each instance, who writes the check?

The Witness: The check is written in our general accounting department.

The Court: Who signs it?

The Witness: Two signatures are required. I am a signer and several, we have several authorized to sign it.

The Court: Who inserts the amount in the check?

The Witness: A man by the name of Detrich who has charge of the membership accounts:

[fol. 173] The Court. How does he determine the amount?

The Witness: By the unexpired portion of that membership.

The Court: Who designated to him his method of determination of amount?

The Witness: The Manager of the Club and the Assistant General Manager.

The Court: I see, that is all.

Mr. Moorman: Step down, Mr. Sasser.

(Witness excused.)

Mr. Moorman: The Petitioner calls Mr. George G.quette.

Whereupon.

QUELETTE, GEORGE G., called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, Mr. Witness.

The Witness: George G. Quelette, address 2000 Buhl Building, Detroit, Michigan.

Direct Examination.

By Mr. Moorman:

Q. What is your employment, Mr. Quelette?

A. Employed by Ernst & Ernst.

Q. Are you familiar with the system of accounts for the Automobile Club of Michigan?

A. I am.

Mr. Moorman: Mr. Clerk, I hand you for identification Petitioner's—

The Clerk: Exhibit 23 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 23 for identification.)

Q. (By Mr. Moorman): Mr. Quelette, I hand you Petitioner's Exhibit 23 for identification, and I ask you will you identify the document I have just handed to you?

A. This is an analysis of deferment of income for membership dues collected per the books of the Automobile Club of Michigan.

[fol. 174] Q. What does this schedule purport to show again?

A. This schedule shows a reconciliation of the differences between dues collected and dues earned.

Q. Did you prepare this schedule?

A. I did.

Q. And where did you get the figures that are shown on this schedule?

A. I got the information from the books and records of the Automobile Club of Michigan.

Mr. Moorman: I offer in evidence as Petitioner's Exhibit Number 23 this schedule.

The Court: Any objections?

Mr. Friedman: There is no objection. As I understand it, it is a compilation made by the witness from the books of the corporation? There is no objection to that.

The Court: There being no objection, the exhibit may be received.

(The document heretofore marked Petitioner's Exhibit No. 23 for identification, was received in evidence.)

Q. (By Mr. Moorman): Mr. Quelette, I call your attention to the line on this schedule which is captioned "Less refunds due to cancellations and duplicate payments, et cetera," and I ask you, do you know what part of the amounts comprising this line, represent actual refunds in membership dues?

A. I do.

Q. Do you have a memorandum of these amounts?

A. I have a memorandum of those figures which were taken from the books of the Club.

Q. And are these the actual refunds that were made in these years?

A. Actual refunds.

Q. Will you read the amounts of those refunds into the record, please?

A. For the year ended December 31, 1943 the amount of refunds due to cancellations of membership were \$13,204.33. The balance of the refunds were due to duplicate payments. The year ended December 31, 1944, the amount of refunds due to cancellation of membership were \$13,347.97. The balance were due to duplicate payments.

[fol. 175] Mr. Friedman: Would you mind repeating that, please?

The Witness: Pardon?

Q. (By Mr. Moorman): Would you repeat that?

A. The amount?

Mr. Friedman: Yes, cancellation.

The Witness: \$13,347.97. For the year ended December 31, 1945, the amount of refunds due to cancellation of memberships were \$17,492.74. The balance were due to duplicate payments. For the year ended December 31, 1946 the amount of refunds due to cancellations of membership were

\$21,867.71. The balance were due to duplicate payments. For the year ended December 31, 1947 the amount of refunds due to cancellation of membership were \$24,778.87. The balance were due to duplicate payments.

Q. (Mr. Moorman): You use this expression "balance due." What do you mean?

A. The balance between the amounts that I read as having been refunds due to cancellations of memberships and the total of the refunds shown on the Exhibit 23.

Q. I see.

Mr. Moorman: Mr. Clerk, would you mark this?

The Clerk: Exhibit 24 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 24 for identification.)

Q. (By Mr. Moorman): Mr. Quelette, I hand you Petitioner's Exhibit 24 for identification, and I ask you will you identify the document I have just handed to you?

A. This is a balance sheet of the Automobile Club of Michigan, at June 30, 1945.

Q. Did you prepare this?

A. I did.

Q. Where did you get the figures that are reflected in there?

A. I got the information from the books and records of the Automobile Club of Michigan.

Mr. Moorman: I offer this in evidence as Petitioner's Exhibit Number 24.

The Court: Any objections?

Mr. Friedman: No. As I understand this is a balance sheet at June 30, 1945, and we already have in evidence balance [fol. 176] sheets for all period- from December 31, 1934 through December 31, 1947.

Mr. Moorman: That is correct. The balance sheets that you have referred to are year ending balance sheets, for the periods that you have just described. This particular exhibit has a purpose in being placed into evidence, the balance sheet as of June 30, 1945. For the reason that one of the positions that the Petitioner is taking in this particular case is that it may come into taxable status as of that day.

The Court: In other words, the exhibit, that is Exhibit Number what?

Mr. Moorman: 24.

The Court: Petitioner's Exhibit 24.

Mr. Moorman: That concludes the direct examination.

Mr. Friedman: There are no questions.

The Court: That is all, witness. Just a minute, Mr. Quette. Do you wish to offer Petitioner's Exhibit 24?

Mr. Moorman: Yes, sir.

The Court: Petitioner's Exhibit 24 will be received.

(The document heretofore marked Petitioner's Exhibit No. 24 for identification, was received in evidence.)

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[fol. 177] BEFORE THE TAX COURT OF THE UNITED STATES
20 T. C. 145

AUTOMOBILE CLUB OF MICHIGAN, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

FINDINGS OF FACT—Promulgated September 23, 1953

Docket No 27988.

1. In 1945 the respondent held that the petitioner was not an exempt organization under the Internal Revenue Code or under prior revenue acts, revoked rulings of exemption made in 1934 and 1938 and required petitioner to file returns for 1943 and 1944. *Held*, that the portion of Regulations 103, Sec. 19.101-1, and the corresponding portions of earlier regulations, providing that where an organization established its right to exemption it need not thereafter make a return of income unless it changed its character, did not operate to exempt petitioner from tax for 1943 and 1944.

2. *Held*, that the period of limitations for assessment and collection of tax for 1943 and 1944 had not expired at the time the respondent mailed the notice of deficiency to petitioner.

3. The petitioner kept its books and filed its returns on the accrual basis. During the taxable years it received payment in advance of annual membership dues without restrictions as to their use and disposition. *Held*, that the entire amount of dues constituted income for the year in which received.

4. Since there is no showing that at any time during its existence prior to January 1, 1943, the petitioner was an organization exempt by law, depreciation or amortization on properties, acquired prior to January 1, 1943, and used [fol. 178] by petitioner in its business after that date, is to be computed on the same basis as if petitioner had always been held to be a corporation subject to tax.

Raymond H. Berry, Esq., and A. H. Moorman, Jr. Esq., for the petitioner.

A. J. Friedman, Esq., and Charles Speed Gray, Esq., for the respondent.

Withey, Judge: The respondent determined deficiencies in the petitioner's income and excess profits taxes as follows:

Year	Deficiencies	
	Income Tax	Excess profits tax
1943	\$49,016.97	\$128,953.72
1944	48,781.99	157,307.29
1945	42,373.66	
1946	13,645.94	
1947	7,365.87	

The principal issues are the correctness of the respondent's action (1) in determining that for the years 1943 through 1947 the petitioner was not exempt from income and excess profits taxes, as a club organized and operated exclusively for pleasure, recreation and other non-profitable purposes, within the purview of section 101(9) of the Internal Revenue Code, (2) in determining that the period of limitations for assessment of tax for 1943 and 1944 had not expired at the time of mailing of the deficiency notice, (3) in determining that the entire amount of membership dues received by petitioner during each of the years 1943 through 1947 is to be included in income for the year in which re-

ceived, and (4) in determining the deductions allowable as depreciation or amortization for the years 1943 through 1947. The parties are agreed that all other issues have been disposed of by stipulation or will be disposed of by our decision of the above/stated issues.

[fol. 179]

GENERAL FINDINGS OF FACT

A portion of the facts have been stipulated and are found accordingly.

The petitioner is a Michigan corporation and has its office and principal place of business in Detroit. It filed its income tax returns, excess profits tax returns and declared-value excess profits tax returns for the years 1943 through 1947 with the collector for the district of Michigan.

Issue 1. Exemption from Taxation.

Findings of Fact

On July 21, 1916, the petitioner was incorporated under the laws of the State of Michigan under the name of Detroit Automobile Club for a term of existence of 30 years. It assumed its present name in 1930 and in 1946 its existence was extended for a further period of 30 years. The petitioner was organized as a non-profit corporation without capital stock or shares and has never paid any dividends.

As set forth in petitioner's Articles of Association and its by-laws, as they existed on January 1, 1940, the purposes or objects of the petitioner were as follows:

To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First" as applied to automobile traffic; to promote touring and to obtain and furnish touring information and obtain the necessary signboarding of public highways; and to co-operate in any work or [fol. 180] movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general.

In January 1941 the petitioner's by laws were amended to provide that petitioner's funds should be used only to accomplish the foregoing purposes or objects of the petitioner.

The petitioner's board of directors have general charge of management and control of the petitioner's affairs and its funds and property. The board is elected annually and its members serve without pay. The functions of the petitioner are carried out by its officers and employees under the direction of the board of directors.

During the years involved herein until May 1947 the petitioner had three classes of membership, namely honorary, life and active. Honorary membership was limited to 25 in number and includes certain Government officials and other persons named by the board of directors. Honorary members pay no dues and have no voting rights. Life membership is obtained by an active member paying \$250 at one time. Life members are exempt from the payment of future dues and assessments but continue to have all the rights of active members. Active memberships are open to persons (male or female) of good moral character over 16 years of age. In May 1947 the by-laws were amended to provide that any person, wife, son or daughter, domiciled in the home of an active member might become an associate member and that such memberships should run concurrently with the active membership with which it was associated.

The petitioner had no entrance fee but its dues for active members were \$10 annually, except that effective October 1, 1946, they were increased to \$12 annually.

To persons soliciting members the petitioner paid \$2.50 for each new member obtained.

The number of members belonging to the petitioner during the indicated years were as follows:

[fol. 181]	1943	212,865
	1944	224,092
	1945	243,630
	1946	261,695
	1947	244,994

Petitioner's by-laws provide for annual meetings of its members. Until some undisclosed time prior to March 15,

1947, 25 members constituted a quorum. Effective March 15, 1947, 10 per cent of petitioner's membership was required to constitute a quorum.

During 1943 through 1947 the petitioner devoted most of its resources and efforts to the bettering of conditions for motorists and the promotion of proper laws relating to the use of the motor car, the promotion of travel and the use of the automobile for other modes of transportation. It engaged in the promotion of safety, the solution of traffic problems and the promotion of the formation of school boy patrols. It organized the school boy patrols in Michigan. To teachers in the schools it furnished textbooks dealing with the conduct and operation of school boy patrols. As a reward it annually took some of the patrol boys to Washington, D. C. Annually it conducted seminars in the University of Michigan to promote the education of school teachers in the state in driver training courses. Petitioner's safety and traffic and engineer departments made surveys throughout the State of Michigan at the request of various cities and communities and many of its proposals as to safety measures were adopted. Petitioner supplied to its members in Michigan and those affiliated with the American Automobile Association emergency road service. The petitioner published and furnished to each of its active members a magazine containing news about travel and news about laws as they pertain to the use of automobiles. Maps and other touring information with reference to road conditions were also provided, as was assistance to the American Automobile Association in its designation or appointment of proper places for tourists to be housed and fed. The petitioner secured reservations for its members when traveling abroad and arranged for the shipping of their cars abroad. Petitioner also promoted and furnished gratis to various communities proper directional and stop signs. In its services the petitioner attempted to do for the motorist in a collective way that which he was unable to do as an individual.

The petitioner does not engage in or conduct any social activities.

During the early part of 1934, the petitioner inquired of respondent as to whether it was exempt from payment of

the capital stock tax imposed by section 215 of the National Industrial Recovery Act. The respondent informed petitioner that in order to determine whether it was entitled to exemption from payment of the capital stock tax he must first determine whether the petitioner was entitled to exemption from Federal income taxation under the provisions of section 103 of the Revenue Act of 1932. Accordingly, respondent requested petitioner to supply certain information concerning its operations, a copy of its financial statement for 1933 showing assets and liabilities and a classified list of its receipts and disbursements. The petitioner replied by letter and enclosed therewith a balance sheet showing its assets and liabilities as of April 30, 1934.

On June 11, 1934, the respondent wrote the petitioner advising it that on the basis of evidence submitted it was held that petitioner was entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that, therefore, it was not required to file returns for 1933 and prior years, and that under the provisions of section 101(9) of the Revenue Act of 1934 it would not be required to file returns so long as there was no change in its organization, its purposes or methods of doing business. The petitioner was further advised that the exemption thereby granted did not apply to taxes levied under other titles or provisions of the respective revenue acts, except in so far as exemption was granted expressly under those provisions to organizations enumerated in section 103 of the Revenue Act of 1932.

[fol. 183] In September 1937, the respondent sent petitioner a questionnaire and requested it to supply certain information concerning its claim for exemption under section 101(9) of the Revenue Act of 1936. The petitioner filled in the questionnaire and returned it to the respondent with a letter and a copy of its financial statement as of December 31, 1936. On July 5, 1938, the respondent wrote petitioner advising that since it appeared that there had been no change in its form of organization or activities which would affect its status, the previous ruling of the Bureau holding it to be exempt from filing returns of income was affirmed under the Revenue Act of 1936.

On May 12, 1945, respondent wrote the petitioner stating

that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations from Federal income taxation in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto as set forth in G.C.M. 23688, C. B. 1943, page 283. Petitioner was requested to furnish the information called for in the form of a blank exemption affidavit which was enclosed. By letter dated June 11, 1945, the petitioner replied to the respondent's request and enclosed therewith the executed exemption affidavit together with a copy of petitioner's articles of incorporation and by-laws and a copy of its balance sheet as at December 31, 1944.

The respondent wrote the petitioner on July 16, 1945, as follows:

Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G.C.M. 23688, C.B. 1943, 283.

Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial (sic) schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.

Section 101(9) of the Internal Revenue Code provides for the exemption of:

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable pur-

poses, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similar provisions.

This office holds that the term "club" as used in the above section of laws contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other non-profitable purposes", within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

[fol. 185] Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

Thereafter the petitioner filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest on the ground that it was exempt from tax.

Opinion

In its petition, the petitioner assigned as error the respondent's determination that it was not exempt from tax for the years 1943 through 1947 under the provisions of

section 101(9) of the Internal Revenue Code.¹ On brief, petitioner states that in view of the decisions in *Chattanooga Automobile Club*, 12 T. C. 967, affd. 182 F. 2d 551; *Keystone Automobile Club*, 12 T. C. 1038, affd. 181 F. 2d 402; and *Automobile Club of St. Paul*, 12 T. C. 1152, it concedes that it was not exempt from tax for taxable years ending after July 16, 1945, the date on which the respondent revoked his previous rulings holding that petitioner was exempt from tax. The petitioner makes no contention that during 1943 and 1944 it was in fact and in law an organization of the class contemplated by section 101(9) of the Code and as such was exempt from taxation for those years. Therefore, we must assume that during those years the petitioner was not an exempt organization under the provisions of that section. However, on other grounds, the petitioner contends that by [fol. 186] having established its tax exempt status in the manner provided by respondent's regulations, and there having been no change in its character, it is entitled under the law to retain its established tax-exempt status for all taxable years ending before the year in which the respondent revoked his prior rulings as to its status. The grounds so relied on are that respondent's rulings of June 11, 1934, and July 5, 1938, show that it had established its right to exemption; that under the respondent's regulations,² relating to

¹ Sec. 101. Exemptions from Tax on Corporations.

The following organizations shall be exempt from taxation under this chapter—

• • • • •

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

² Regulations 103, Sec. 19.101-1 * * *

• • • • •

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or opera-

section 101 of the Code when it established its right to exemption it was not thereafter required to make a return of income or any further showing with respect to its status unless it changed its organization, operations or purposes for which created and that no such changes occurred; that under the principle applied in *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, the foregoing regulations having been of long standing acquired the force and effect of law by reason of the successive reenactments in the various revenue acts and the Code of provisions corresponding to section 101 of the Code; and that, accordingly, respondent's authority to revoke his prior rulings did not extend to a taxable year prior to that in which the revocation is made where the revocation is not based on a change made by the taxpayer in its organization, operations or purpose of creation.

The petitioner's contentions present the question of whether the regulations relied on by petitioner were intended to have the meaning attributed to them by the [fol.187] petitioner. In *Southern Maryland Agricultural Fair Association*, 40 B. T. A. 549, we had occasion to consider the meaning and effect of such regulations. In that case the Commissioner issued a ruling in 1924 holding that the taxpayer was exempt from tax. Believing that the ruling relieved it from the duty of filing returns, the taxpayer did not file any returns for the years 1923 through 1935. Early in 1937 the Commissioner reversed the ruling made in 1924 and held that the taxpayer was not and never had been exempt and notified the taxpayer accordingly. He also determined deficiencies against the petitioner for the years 1921 through 1935. There the applicable regulations as to

tions or the purpose for which it was originally created. * * * Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

• • • • •
All the regulations from Regulation 33, issued under the Revenue Act of 1916, to Regulations 103, issued under the Code, have contained provisions substantially identical with the foregoing.

corporations establishing exemption and the lack of necessity thereafter for filing returns were substantially the same as the regulations involved here. Two questions were presented, namely, whether the 1924 ruling and the applicable regulations excused the taxpayer from filing returns for the years 1923 through 1935 and whether the Commissioner had authority to reverse the 1924 ruling. In deciding both questions adversely to the taxpayer, we stated that although the Commissioner could not change the law by regulations, he could make reasonable regulations to assist him in administering the act and deciding whether a particular corporation was or was not exempt by statute. We concluded that was what he had done by the regulations there involved and held that such regulations were intended to be and were administrative, not legislative. Further, we stated that the inference should not be drawn from the regulations that the respondent thereby intended to write the limitation provisions of the revenue acts words which would provide a different period of limitations from that provided in the revenue acts for the benefit of those corporations which he might erroneously conclude were exempt. We held that the Commissioner could not thus change the law if he so desired.

Considering the petitioner's contentions here in the light of what was said in the *Southern Maryland Agricultural Fair Association* case, we must conclude that the regulations here relied on were not intended to, and did not, in any way modify or change the provisions of the revenue acts and the Code relating to exempt organizations. Or- [fol. 188] ganizations that were actually exempt were made so by the provisions of the revenue acts and the Code. They were not required to file any returns and the Commissioner could not change their status by regulations. Organizations not coming within the provisions of the revenue acts and the Code relating to exempt organizations were not exempt and the regulations in question neither purported to, nor could make them exempt.

In the *Reynolds Tobacco Co.* case, the question for decision was whether gain accruing to a corporation from the purchase and resale of its own shares constituted gross income within the meaning of section 22(a) of the Revenue Act of 1928. Under the Revenue Act of 1928, the Commis-

sioner issued a regulation to the effect that a corporation realized no gain or loss from the purchase or sale of its own stock. At least from 1920 such administrative construction was uniform with respect to each of the revenue acts from that of 1913 through 1932. In May 1934 the regulation was amended to provide that where a corporation deals in its own share- as it might in the shares of another corporation, the resulting gain or loss was to be computed in the same manner as though the corporation were dealing in the shares of another. In 1929 the taxpayer sold certain of its shares acquired in that and prior years for a sum which exceeded cost. The Court concluded that since successive revenue acts had reenacted without alteration the definition of gross income as it stood in the acts of 1913, 1916 and 1918, Congress must be taken to have approved the administrative construction represented by the earlier regulation and thereby to have given it the force of law. Accordingly, the Court held that the amended regulation was not to be applied retroactively and that the taxpayer's tax liability for 1929 was to be determined under the regulation in force in 1929.

Clearly the situation here is different from that presented in the *Reynolds Tobacco Co.* case. The regulations involved there were legislative in nature in that they purported to determine what did or did not constitute gain or loss. The regulations here involved were administrative in character and in nowise purported to determine whether [fol. 189] any organization was or was not exempt. Accordingly, the holding in the *Reynolds Tobacco Co.* case does not have here the effect contended for by petitioner.

The petitioner also had made some argument to the effect that it has been discriminated against by the respondent in that here the respondent has determined deficiencies against it for the years 1943 and 1944 when notice of revocation of respondent's ruling of exemption was not sent until during 1945, whereas in the case of all other automobile clubs, the respondent has not determined a deficiency for any year earlier than that in which notice of revocation of his ruling of exemption was sent. So far as appears from the reports of the cases mentioned in this connection by petitioner, the respondent has made all revocations of his rul-

ings of exemption effective for the taxable years, calendar or fiscal, beginning in 1943. Since the respondent has not determined a deficiency against the petitioner for any year earlier than the calendar year 1943, we cannot find that petitioner has been discriminated against.

The respondent is sustained on this issue.

Issue 2. Period Limitations

Findings of Fact

On August 12, 1944, the petitioner filed with the collector for the district of Michigan, for the calendar year 1943, Treasury Department Form 990, an annual return which section 54(f) of the Internal Revenue Code³ required should be filed by organizations exempt from income tax under section 101 of the Internal Revenue Code, or under corresponding provisions of prior revenue acts. On May 17, 1945, the petitioner filed a like form for the calendar year 1944. The foregoing returns showed gross income and receipts and disbursements and contained statements of assets and liabilities at the end of the respective years. [fol. 190] Such returns were not the returns required by section 52(a) of the Code from corporations subject to tax under Chapter 1 of the Code and did not provide sufficient data from which the petitioner's income and excess profits tax liability for 1943 and 1944 could be computed and assessed.

The petitioner's income and excess profits tax returns (Forms 1120 and 1121) for the calendar years 1943 and 1944 were filed on October 22, 1945. On August 25, 1948, petitioner and the respondent entered into consents which provided that the amounts of any income, excess profits or war profits taxes due for the taxable years ended December 31, 1943 and December 31, 1944, could be assessed at any time on or before June 30, 1949. On May 23, 1949, they executed consents which provided that such taxes for said years could be assessed at any time on or before June

³ Section 54(f) was added to the Code by section 117 of the Revenue Act of 1943 and was made applicable for taxable years beginning after December 31, 1942.

30, 1950. The notice of deficiency forming the basis of this proceeding was mailed to the petitioner on February 20, 1950.

Opinion

The petitioner contends that even if it be determined that the respondent had authority to determine deficiencies against it for 1943 and 1944, we must conclude that the notice of deficiency was not sent within the applicable periods of limitations and that assessments of the deficiencies for those years are barred because the periods of limitations began to run prior to the filing of the income and excess profits tax returns on October 22, 1945. The petitioner concedes that under section 275(a) of the Code the period of limitations begins to run from the filing of the return. However, it contends that where a taxpayer is not under a duty to file a return for a given year, the period of limitations for such year begins to run from the [fol. 191] date the return should have been filed if there had been a duty to file it. In support of its position the petitioner relies on *Balkan Nat. Ins. Co. v. Commissioner*, 101 F. 2d 75, and *Stockstrom v. Commissioner*, 190 F. 2d 283.

In the *Balkan Nat. Ins. Co.* case, the Alien Property Custodian seized all of the records of a foreign corporation prior to the time the return for 1918 was due and the records were never returned to the corporation. The corporation never filed any return. It was held that the statute had run in 1934 against assessment of a deficiency for 1918 since the Government had made it impossible for the corporation to file any return for 1918. Obviously the present case is not like that case nor is it as strong factually for the taxpayer. The petitioner at all times was in possession

* Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in section 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

of its records. In the *Stockstrom* case, the donor of gifts to trusts filed a gift tax return for 1936 and paid the tax thereon computed in accordance with the Commissioner's then outstanding ruling as to exclusions for gifts to trusts. Thereafter in 1937, and on the basis of certain court decisions, the Commissioner reversed his ruling as to exclusions for gifts to trusts. On the basis of the new ruling the respondent refunded the donor's gift tax paid for 1936 and approved the exclusions taken, on the basis of the new ruling, in the donor's 1937 gift tax return. On the basis of the new ruling, the donor was not liable for gift tax for 1938 and filed no return for that year. In 1941 a revenue agent obtained the facts and figures as to gifts made to trusts in 1938. He and another employee of the Bureau considered the liability of the donor for gift tax for 1938 and the donor was informed that there was no liability. In 1948, and on the basis of a Supreme Court decision rendered in March 1941, the respondent reversed his 1937 ruling and determined a deficiency in gift tax for 1938. The Court concluded that when the facts and figures as to the donor's gifts in 1938 were obtained in 1941, it was the collector's duty promptly to file a return for the donor for 1938, that such duty should not have been postponed for years in order to prevent the statute of limitations from running and held that assessment of the deficiency was barred. Clearly the instant case is distinguishable on its facts from the *Stockstrom* case.

[fol. 192] Here, the respondent on July 16, 1945, and in the same notice in which he determined that the petitioner was not exempt from tax and in which he revoked his prior rulings, requested the petitioner to file income tax returns for 1943 and 1944. So far as shown no revenue agent or other employee of the Bureau theretofore had made an investigation of the petitioner's affairs and obtained from petitioner data upon which to compute its income tax liability for those years.

Because of factual differences we are unable to find that the decisions in the *Balkan Nat. Ins. Co.* and *Stockstrom* cases are applicable here.

In *Southern Maryland Agricultural Fair Association*, *supra*, we considered the question of whether an erroneous

ruling by respondent (subsequently revoked) that a corporation was exempt from tax was effectual, with respect to taxable years prior to that of revocation, for starting the running of the statutory period of limitations and held that it was not. We think our holding there is applicable here.

The petitioner further urges that the periods of limitations began to run for 1943 and 1944 when it filed Forms 990 for the respective years. It contends that such forms contained sufficient data from which its income and excess profits tax liability for such years could be computed and assessed and that, consequently, such forms are to be considered as the returns contemplated by section 275(a) of the Code. From a comparison of Forms 990 filed by the petitioner for 1943 and 1944 with the income and excess profits tax returns filed for those years, we have found that the Forms 990 do not contain sufficient data from which the petitioner's income and excess profits taxes for those years could be computed and assessed. In a similar situation in *John Danz*, 18 T. C. 454 (on appeal, C. A. 9), we held that the Forms 990 were not sufficient to start the running of the period fixed by section 275(a) of the Code for assessment and collection of the tax due. On authority of our holding there, the contention of the petitioner is denied.

[fol. 193] Issue 3. Inclusion of Membership Dues in Income
Findings of Fact

The petitioner collected dues from its members in the following amounts during the indicated years:

1943.....	\$2,126,437.50
1944.....	2,237,017.04
1945.....	2,430,543.97
1946.....	2,744,897.65
1947.....	2,914,028.76

The money collected by petitioner from its members as dues was deposited by it in a general bank account which it maintained with the National Bank of Detroit. This was an account in which all money received by petitioner was deposited. At no time was the money received by petitioner as dues segregated from its general funds or deposited in

a bank account other than the one general account in which all of its other receipts were deposited.

Upon receipt of a member's dues, the petitioner set aside \$1 to pay for a subscription to a magazine called "Motor News." If the members were a new member and had been brought in by one of the petitioner's solicitors or employees a commission of \$2.50 was paid to the person bringing in the member.

Prior to March 15, 1947, petitioner's by-laws provided that a member whose annual dues remained unpaid for 30 days after becoming due was subject to suspension from the privileges offered by petitioner. If a member failed to pay his dues within 30 days after notice of his suspension, he ceased to be a member of petitioner and became liable for the payment of two months' dues as well as the expense of collecting them. Any member who resigned forfeited all his rights and interests in the petitioner's property and assets. A new by-law effective March 15, 1947, provided for the termination of membership by death, resignation, non-payment of dues, or upon other reasonable [fol. 194] cause by written notice to the member, or upon order of petitioner's board of directors, and for the sending by petitioner with the notice of termination a check for the unused portion of annual dues as determined by petitioner's board of directors. Petitioner's board of directors has never adopted a resolution fixing the amount, or providing a formula for ascertaining the amount, of a refund to be paid to persons who ceased to be members of the petitioner.

Although prior to March 15, 1947, the petitioner's by-laws did not provide for the refunding of a portion of annual dues upon the termination of a membership, it had been petitioner's policy since about 1924 to refund a portion of the unearned dues upon the termination of a membership. However, there was no "iron-bound" rule under which the amounts of such refunds were computed.

Membership dues are paid in advance for one year. When a member's dues are received, the petitioner credits the amount thereof to an account carried as a liability account and designated "Unearned Membership Dues." During the first month of membership and each of the following

11 months, one-twelfth of the amount paid is credited to an income account designated "Membership Income". The foregoing method of accounting with respect to membership dues has been followed by petitioner since 1934 and the income from membership dues reported by petitioner in its returns for 1943 through 1947 was ascertained by petitioner under that method.

The petitioner's returns for each of the years 1943 through 1947 was prepared on the basis of a calendar year and on the accrual method of accounting.

The respondent determined that the entire amount of membership dues received by petitioner during the years involved herein should be reported as income for the year in which received.

[fol. 195]

Opinion

Under the method employed by petitioner in accounting for, and reporting, income from membership dues, such dues are treated as earned ratably over the period of the membership and each month one-twelfth of a member's annual dues is included in petitioner's income as representing income actually earned. That portion of a member's dues received in a given taxable year which, under the petitioner's method, is not included in income for the year in which received, is deferred and included in income in the following year. The respondent determined that the entire amount of membership dues received during a taxable year is to be included and reported in income for the year in which received. In effect the petitioner claims that because the income as determined by respondent embraces unearned income and also embraces receipts which may subsequently be subject to refund, the respondent's determination fails properly to reflect income.

In *Brown v. Helvering*, 291 U. S. 193, affirming 22 B. T. A. 678, the taxpayer was a general insurance agent and kept books on the accrual basis. During the taxable years there involved the taxpayer received, without restrictions as to their use and disposition by it, commissions on fire insurance policies written for one, three and five year terms. It was held that the entire amount of commissions received

in the respective taxable years constituted income to the taxpayer for the years in which received even though they were received before they were earned and some portion of them might have to be refunded in the future.

In *South Tacoma Motor Co.*, 3 T. C. 411, a taxpayer on the accrual basis attempted to defer certain sums received from the sale of coupon books which entitled the purchaser to services which might be demanded and performed after the year of sale, and reported as gross income only that portion of the sums received which were allocable to the services it performed during the taxable year. In support of its deferment of income the taxpayer contended that the nature of its contract was such that it would have to perform many of the services required by the contract subsequent to the taxable year in which the coupon book was sold. We held that the entire amount received from the sale of the coupon books was income for the taxable year in which received.

In *Your Health Club, Inc.*, 4 T. C. 385, a taxpayer on the accrual basis received certain cash and accrued amounts within the taxable year under contracts obligating it to perform services extending beyond the taxable year. We there held that the entire amount constituted income in the year when received or accrued despite the fact that a part of the income was earned during the following year.

In view of the decisions in the foregoing cases, we hold that the entire amount of membership dues received by petitioner during the years here involved constituted income for the year in which received.

Since the entire amount of membership dues was income for the year in which received and since the petitioner's method of accounting for income did not take cognizance of the full amount thereof for such year, it is apparent that the petitioner's method of accounting did not clearly reflect its income. Accordingly, the respondent did not err in determining that petitioner's method of accounting did not clearly reflect income, and in further determining that the entire amount of membership dues received during the taxable years in question constituted income for the years in which received.

[fol. 197]

Issue 4. Depreciation

Findings of Fact

Prior to December 31, 1936, petitioner capitalized on its books additions to furniture and fixtures accounts and the leasehold improvements and building alterations account and periodically made provision for depreciation and amortization with respect thereto. At December 31, 1936, the petitioner charged to its surplus account the undepreciated balances of those accounts by journal entries summarized as follows:

Cost of assets at December 31, 1936:

Office furniture and fixtures—Detroit	\$ 32,894.67	
Office furniture and fixtures—Branches	20,925.23	
Leasehold improvements and building alterations	177,025.73	\$230,845.63

Less accumulated reserves for depreciation and amortization to December 31, 1936:

Office furniture and fixtures—Detroit	\$ 17,918.08	
Office furniture and fixtures—Branches	12,264.58	
Leasehold improvements and building alterations	177,025.73	207,208.39

Undepreciated balance charged to surplus		\$ 23,637.24
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Subsequent to December 31, 1936, the petitioner charged to expense the cost of furniture and fixtures and building alterations. There were no leasehold improvements subsequent to that date.

Both prior to December 31, 1936, and subsequent thereto petitioner capitalized on its books additions to its auto-[fol. 198] mobiles and trucks account and periodically made provision for depreciation with respect thereto on the basis of a 4-year life.

At January 1, 1943, petitioner had depreciable and amortizable assets, the investment in which (except for automobiles and trucks) was not reflected in its accounts as of that date, such investment having been charged off or expensed previously. The time of acquisition, the cost, the amount of depreciation or amortization sustained to January 1, 1943, the cost less sustained depreciation or amortization to January 1, 1943, and the remaining lives from

January 1, 1943, of these assets are as set forth in the following schedules:

OFFICE FURNITURE AND FIXTURES

Year	Cost	Depreciation sustained to Jan. 1, 1943	Cost, less depreciation sustained to Jan. 1, 1943	Remaining life at Jan. 1, 1943 in years
1928	\$ 9,133.15	\$ 8,829.02	\$ 304.13	1½
1929	6,179.28	5,561.35	617.93	1½
1930	13,159.95	10,966.19	2,193.76	2½
1931	9,393.81	7,201.95	2,191.86	3½
1932	2,192.79	1,534.95	657.84	4½
1933	1,214.11	768.93	445.18	5½
1934	3,611.72	2,046.65	1,565.07	6½
1935	5,531.43	2,765.72	2,765.73	7½
1936	7,295.13	3,260.99	4,034.16	8½
1937	19,724.59	7,232.42	12,492.17	9½
1938	18,672.45	4,356.28	14,316.17	10½
1939	17,420.39	5,226.12	12,194.27	11½
1940	17,772.62	2,962.16	14,810.46	12½
1941	25,035.77	2,503.58	22,532.19	13½
1942	13,897.64	463.25	13,434.39	14½

Total Jan. 1, 1943	\$170,234.87	\$65,679.56	\$104,555.31
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[fol. 199]

AUTOMOBILES AND TRUCKS

Description	Date acquired	Cost	Depreciation sustained to Jan. 1, 1943	Cost, less depreciation sustained to Jan. 1, 1943	Remaining life at Jan. 1, 1943 in months
Ford Sedan	4/40	\$ 675.00	\$ 464.06	\$ 210.94	15
Special Trailer	6/40	720.00	465.00	255.00	17
Plymouth Coupe	7/40	798.25	498.91	299.34	18
Chrysler Brougham	12/40	926.91	482.76	444.15	23
Ford '41 E. R. S. Truck Chassis	11/40	790.00	427.92	362.08	22
Plymouth Panel Del. Truck	3/41	677.71	310.61	367.10	26
Special Body	1/41	275.00	137.50	137.50	24
Plymouth 2 Dr. Sedan	3/41	766.32	351.23	415.09	26
Plymouth Panel Delivery	3/41	784.86	359.72	425.14	26
Chrysler C-30 Six Pass. Sedan	3/41	1,540.40	706.01	834.39	26
Mercury Coupe	5/41	988.80	411.99	576.81	28
Chrysler C-28 DeLuxe Brougham	6/41	958.98	379.59	579.39	29
Pontiac DeLuxe 6 4-Dr.	6/41	811.35	321.16	490.19	29
Ford DeLuxe Coupe	7/41	812.49	304.68	507.81	30
Pontiac—(used)	6/42	800.00	116.67	683.33	41
Plymouth DeLuxe Coupe (used)	9/42	750.00	62.50	687.50	44
		\$13,076.07	\$5,800.31	\$7,275.76	

[fol. 200]

LEASEHOLD IMPROVEMENTS

Year Made	Cost	Depreciation sustained to Jan. 1, 1943	Cost, less depreciation sustained to Jan. 1, 1943	Remaining life at Jan. 1, 1943	Years Months
1926	\$ 96,677.35	\$47,855.29	\$48,822.06	16	10
1927	54,379.07	25,286.27	29,092.80	17	10
1931	1,036.00	357.42	678.58	21	10
	<u>\$152,092.42</u>	<u>\$73,498.98</u>	<u>\$78,593.44</u>		

BUILDING ALTERATIONS

Year Made	Cost	Depreciation sustained to Jan. 1, 1943	Cost, less depreciation sustained to Jan. 1, 1943	Remaining life at Jan. 1, 1943	Years Months
1927	\$ 491.00	\$ 228.31	\$ 262.69	17	10
1931	1,233.00	425.38	807.62	21	10
1936	190.00	37.05	152.95	26	10
1937	16,022.73	2,643.75	13,378.98	27	10
1938	5,877.67	793.49	5,084.18	28	10
	<u>\$23,814.40</u>	<u>\$4,127.98</u>	<u>\$19,686.42</u>		

SPECIAL ASSESSMENT FOR WIDENING BAGLEY AVENUE

Date	Cost	Amortization sustained to Jan. 1, 1943	Cost, less amortization sustained to Jan. 1, 1943	Remaining life at Jan. 1, 1943
Sept. 1934	\$5,236.77	\$538.75	\$4,698.02	72 yrs., 8 mos.

During the years 1943 to 1947, inclusive, there were no additions to the foregoing property accounts nor any retirements therefrom except as set forth in the following table:

[fol. 201]

Years	Furniture and Fixtures Additions	Automobiles and Trucks Additions	Retirements
1943	\$17,407.46	\$ 6,535.98	\$ 988.80
1944	7,688.23	—0—	—0—
1945	11,636.43	1,906.25	—0—
1946	25,233.84	2,549.16	2,953.51
1947	36,765.03	29,769.17	7,230.61

Opinion

The principal controversy under this issue is as to the basis upon which depreciation or amortization allowances are to be computed with respect to the properties set out in our findings and which were used by petitioner in its business during some or all of the years 1943 through 1947.

In determining the deficiencies the respondent allowed depreciation or amortization deductions computed on the basis of cost as adjusted for depreciation or amortization during the period of petitioner's ownership prior to January 1, 1943. The petitioner takes the position that it had a tax-exempt status for all years prior to 1943, that the respondent's method of determining the allowances was erroneous, and that for the years 1943 through 1947 it was entitled to depreciation or amortization deductions computed on the basis of cost without adjustment for depreciation or amortization occurring prior to January 1, 1943. Pertinent provisions of the Code as set out below.⁵

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

• • • • •

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

• • • • •

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a

⁵ Sec. 114. Basis for Depreciation and Depletion.

percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(C) in respect of any period prior to March 1, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained:

[fol. 202] From the record before us we are unable to conclude, as petitioner contends, that it had an exempt status for all years prior to 1943. While it is true that by his rulings in 1934 and 1938 the respondent held that the petitioner was entitled to exemption under the Revenue Act of 1936 and prior revenue acts, in 1945 he ruled that the petitioner was not entitled to exemption under the Code or prior revenue acts and revoked the 1934 and 1938 rulings. Since the 1945 ruling cancelled the earlier ones, any presumption as to the correctness of the earlier rulings was thereby removed. So far as shown the petitioner was not at any time during its existence within that class of organizations exempted by the sections of the revenue acts under which the respondent in 1934 and 1938 ruled that it was exempt or within that class of organizations exempted by the corresponding sections of later revenue acts and the Code. Therefore, we are without any basis, factual or otherwise, upon which to find that the petitioner ever had an exempt status [fol. 203] at anytime. Therefore, it is apparent that the petitioner has rested its position on a ground not shown to have ever existed. So far as appears, the petitioner has always been subject to tax and it is not apparent why for purposes of computing the depreciation allowances for the years 1943 through 1947 the assets in question had any different basis from that provided in the Code. Furthermore, the basis proposed by petitioner would burden income for 1943 and later years by requiring the allowances in those years for all depreciation that actually had occurred prior to January 1, 1943. The petitioner cites no case to support such action and we have not found any.

In 1932, in G.C.M. 10857, C.B. XI-2, page 105, it was

held under the provisions of sections 111(a) and (b) and 113(b) of the Revenue Act of 1928 that where an organization, which was shown to have been exempt under the Revenue Act of 1928 and all prior revenue acts, derived taxable gain in 1931 from the sale of its property, the basis should not be reduced by the amount of depreciation sustained with respect to the property for the period during which the organization occupied an exempt status. In 1952, in G.C.M. 27491, C.B. 1952-2, page 221, G.C.M. 10857 was reconsidered and revoked, and it was held that in the case of an organization which was exempt from tax for a prior period and subsequently became subject to tax, in computing the amount of gain or loss from the sale or exchange of property held during all or part of the period it was exempt, the basis should be reduced by the amount of depreciation sustained with respect to the property for the period held while the taxpayer was exempt. In I.T. 4106, C.B. 1952-2, page 130, it was held that under the authority contained in section 3791(b) of the Internal Revenue Code, the provisions of G.C.M. 27491 revoking G.C.M. 10857 would be applicable only to sales occurring in taxable years beginning after December 31, 1950.

The petitioner urges that the holding in G.C.M. 10857 sustains its position that its depreciation or amortization deductions for the years 1943 through 1947 are to be computed on the basis of cost without adjustment for depreciation or amortization occurring prior to January 1, 1943, and that the holding in I.T. 4106 gives the petitioner the benefit of G.C.M. 10857 for all the foregoing years. G.C.M. 10857 involved an organization which was shown to have been exempt during the years in which the depreciation there in question occurred. No such showing has been made with respect to petitioner. Because of this factual difference, G.C.M. 10857 would not aid the petitioner even though it be conceded that it correctly interpreted the law. Having reached this conclusion, it becomes unnecessary to consider petitioner's contention as to the benefit conferred by the holding in I.T. 4106.

The petitioner contends that if it is not entitled to the use of a basis of cost without adjustment for depreciation or amortization prior to January 1, 1943, then it is entitled

to use as its basis the fair market value of the properties on January 1, 1943. The basis here contended for does not come within the provisions of the Code, *supra*, defining basis. Consequently, the contention of the petitioner must be denied.

In view of what has been said above, it is our opinion that the petitioner's basis for computing depreciation on the properties here involved for the years in question is the same as if the petitioner always had been held to be a corporation subject to tax.

An issue as to the rate of depreciation allowable for the years in controversy with respect to two branch office buildings acquired by petitioner in 1942 has been settled by a stipulation that a rate of 2 per cent is allowable.

An issue as to the amount of the deduction allowable for the years in question as amortization of the petitioner's investment in a leasehold interest acquired by petitioner in 1926 has been disposed of by a stipulation that an amount of \$3,089.89 is allowable.

Reviewed by the Court.

Decision will be entered under Rule 50.

[fol. 205] BEFORE THE TAX COURT OF THE UNITED STATES

[Title omitted]

EXCERPTS FROM PETITIONER'S BRIEF

(Pages 32 and 33)

ARGUMENT

Preliminary

Petitioner contends that no tax may be assessed against it for the years 1943 and 1944 for the reason, first, that it was exempt from taxation during those years, and secondly and alternatively, that the statute of limitations bars the assessment of any tax liability which may have existed for

those years. The following argument first discusses these issues of tax-exemption and the statute of limitations, which do not involve the asserted deficiencies for the years 1945, 1946 and 1947, since the major portion of the asserted deficiencies for all years will be disposed of if the petitioner prevails on these issues applicable only to 1943 and 1944. If the petitioner is not subject to tax for the years 1943 and 1944, there is no need for the Court to consider the issues and arguments as to the amount of the allowable carry-backs to 1943 and 1944 of net operating losses and unused excess profits credits for the years subsequent to 1944.

[fol. 206] Petitioner is Exempt from Taxation
for the Years 1943 and 1944

In its petition to this Court, petitioner alleged it was exempt from taxation, under the provisions of section 101(9) of the Internal Revenue Code, for all taxable years involved in this proceeding. Petitioner now concedes, in view of the decisions of this Court in *Chattanooga Automobile Club*, 12 T. C. 967 (1949), aff'd 182 F. (2d) 551 (6th Cir. 1950), *Keystone Automobile Club*, 12 T. C. 1038 (1949), aff'd 181 F. (2d) 402 (3rd Cir. 1950), and *Automobile Club of St. Paul*, 12 T. C. 1152 (1949) that it is not exempt from taxation for taxable years ending after July 16, 1945, the date on which the Commissioner revoked his previous rulings holding that petitioner was exempt from taxation.

Petitioner submits, upon application of the principle enunciated by the Supreme Court in its decision in *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 83 L. Ed. 536 (1939), that the petitioner must be held exempt from taxation for the years 1943 and 1944 and that the Commissioner's attempt on July 16, 1945 to revoke retroactively the tax-exempt status of petitioner was without legal effect.

On June 11, 1934, the Commissioner of Internal Revenue in a letter to petitioner ruled that petitioner was exempt from taxation under section 103(9) of the Revenue Act of 1932, which is identical in language with the existing provisions of section 101(9) of the Code. In the ruling of July 11, 1934, the Commissioner, after advising that petitioner was exempt from taxation, further ruled as follows: /

[fol. 206a] IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 12,247

AUTOMOBILE CLUB OF MICHIGAN, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition for Review of the Decision of the Tax Court
of the United States

APPENDICES TO RESPONDENT'S BRIEF—Filed June 17, 1955

[File Endorsement Omitted]

[fols. 207-208] BEFORE THE TAX COURT OF THE UNITED STATES
APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as
deductions:

(n) *Basis for Depreciation and Depletion.*—The basis
upon which depletion, exhaustion, wear and tear, and
obsolescence are to be allowed in respect of any prop-
erty shall be as provided in section 114.

(26 U.S.C. 1952 ed., Sec. 23)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of
the taxpayer's annual accounting period (fiscal year
or calendar year, as the case may be) in accordance
with the method of accounting regularly employed in

keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. . . .

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by [fol. 209] the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. . . .

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made

by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

(26 U.S.C. 1952 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the [fol. 210] approval of the Secretary, may from time to time prescribe.

(b) *To Determine Liability to Tax.*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

(f) [As added by Sec. 117(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. . . .

(26 U.S.C. 1952 ed., Sec. 54.)

SEC. 101 EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, [fol. 211] no part of the net earnings of which inures to the benefit of any private shareholder;

(26 U.S.C. 1952 ed., Sec. 101.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if

computed without reference to discovery value or a percentage of income;

(26 U.S.C. 1952 ed., Sec. 113.)

[fol. 212] SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

(26 U.S.C. 1952 ed., Sec. 114.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(26 U.S.C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the

tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in [fol. 213] writing made before the expiration of the period previously agreed upon.

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 3791. RULES AND REGULATIONS.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1952 ed., Sec. 3791.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.52-1. *Corporation Returns.*—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. . . .

Sec. 29.101-1 [As amended by T. D. 5381, 1944 Cum. bull. 188, 189]. *Proof of Exemption Prior to January 1, 1943.—Annual Returns for Accounting Periods Beginning Prior to January 1, 1943.*—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under sec-

tion 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, [fol. 214] filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption * * * under section 101(9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101(5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation * * *

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further

showing with respect to its status under the law, unless [fol. 215] it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101(5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *.

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

Sec. 29.101-2 [As added by T.D. 5381, *supra*]. *Proof of Exemption on or after January 1, 1943.—Annual Returns for Accounting Periods Beginning on or After January 1, 1943.—(a) Proof of exemption.*—An organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of affidavit or questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any collector: For organizations claiming exemption * * * under section 101(9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, dec-

[fol. 216] laration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

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In addition to the information specifically called for by these regulations the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

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(c) Collector's duties with respect to proof of exemption.—The collector, upon receipt of the affidavit or questionnaire and other papers constituting the proof of exemption by an organization claiming exemption from tax under section 101, will forward completed documents to the Commissioner for decision as to whether the organization is exempt.

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(e) Requirement of annual returns.—For accounting periods beginning after December 31, 1942, every organization exempt from tax under section 101, regardless of the amount or source of its income or receipts and irrespective of whether it is chartered by, or affiliated or associated with, any central, parent, or other organization, except organizations specifically exempted from filing annual returns by section 54(f) (see subsection (h) of this section), shall file annually with the collector for the district in which is located [fol. 217] the principal place of business or principal office of the organization a return of information on

Form 990 (revised May, 1944) specifically stating the items of gross income, receipts, and disbursements and such other information as may be prescribed by the Commissioner in the instructions on the form or issued by him therewith. . . .

(g) *Date for filing annual returns.*—The annual return of information, Form 990 (revised May, 1944), for accounting periods beginning after December 31, 1942, but ending prior to April 1, 1944, shall be filed on or before August 14, 1944, and for accounting periods beginning after December 31, 1942, but ending after March 31, 1944, shall be filed on or before the 15th day of the fifth full calendar month following the close of the period for which the return is required to be filed: . . .

(i) *Collector's records.*—Collectors will keep a list of all organizations held to be exempt from tax to the end that they may occasionally inquire into their status and ascertain whether or not they are (1) observing the conditions upon which their exemption is predicated, and (2) annually filing returns on Form 990 (revised May, 1944) if they are required to file such returns.

(j) *Records, statements, and other returns of tax-exempt organizations.*—An organization which has established its right to exemption from tax under section 101 and has also established that it is not required to file annually the return of information on Form 990 (revised May, 1944) shall immediately notify in writing the collector for the district in which is located its principal office of any changes in its character, operations, or purpose for which it was originally created.

Every organization which has established its right to exemption from tax, whether or not it is required to [fol. 218] file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him

to inquire further into its exempt status and to administer the provisions of section 54(f) and this section. For requirement as to keeping of permanent books of account or records, see section 29.54-1.

An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54(f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the duty of filing other returns of information (see sections 147 and 148).

Sec. 29.101(9)-1. *Social Clubs*.—The exemption granted by section 101(9) applies to practically all social and recreation clubs which are supported by membership fees; dues, and assessments. If a club engages in traffic in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

[fol. 219] BEFORE THE TAX COURT OF THE UNITED STATES

APPENDIX B

AUTOMOBILE CLUB OF MICHIGAN, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 27988

DECISION—Entered December 11, 1953

Pursuant to the determination of this Court, as set forth in its Findings of Fact and Opinion, promulgated September 23, 1953, the parties filed an agreed computation for entry of decision. In accordance therewith, it is

ORDERED AND DECIDED: That there are deficiencies in income tax for the years 1943, 1944, 1945, 1946 and 1947 in the respective amounts of \$100,057.28, \$120,492.92, \$40,994.96, \$2,916.76 and \$2,006.44; that there is a deficiency in excess

profits tax for the year 1943 in the amount of \$24,991.45; and that there is no deficiency in excess profits tax for the year 1944.

/S/ Norman O. Tietjens,
Judge

[fol. 220]. BEFORE THE TAX COURT OF THE UNITED STATES
/EXHIBIT 13

TAXPAYER'S INCOME AND DECLARED VALUE EXCESS PROFITS
TAX RETURN FOR 1943

SCHEDULE K—OTHER DEDUCTIONS

AUTOMOBILE CLUB OF MICHIGAN

Year ended December 31, 1943

Commissions	\$ 178,129.59
Printing, stationery, and office supplies	216,471.78
Telephone and telegraph	63,055.28
Directors' and department heads' meetings	1,368.85
Traveling	29,751.64
Automobile expense	7,185.98
Dues and memberships	558.75
Entertainment	1,415.82
Legal expense	1,823.50
Maps and guides	16,072.65
License expense	831.50
Ticket office expense	516.72
Emergency road service	548,364.58
Ponchos, hats, arm bands, etc.	11,272.08
Dinners, banquets, etc.	2,511.10
Postage and mailing	49,051.22
Cuts, mats, photos, etc.	8,182.36
Auditing	1,600.00
Insurance	7,335.09
Club emblems	1,069.12
AAA dues	52,969.25
Special representative	2,363.45
Safekeeping service	1,720.91
Signs	3,097.04
Employees' pension plan	37,702.17
Light, heat, and water	15,813.96
Advertising	9,933.54
Accident policy premiums	66,240.98
Radio broadcasts	28,089.82
Janitor supplies	5,270.97
Editorials	1,047.50
Agency discount	3,449.24
Miscellaneous	19,240.06
Amortization of improvements to leased property	8,226.62
	<hr/>
	\$1,401,733.12
Less portion charged to Detroit Automobile Inter-Insurance Exchange	159,919.27
	<hr/>
TOTAL	\$1,241,813.85

[fols. 221-222] BEFORE THE TAX COURT OF THE UNITED STATES

EXHIBIT 15

TAXPAYER'S INCOME AND DECLARED VALUE EXCESS PROFITS
TAX RETURN FOR 1944

SCHEDULE K—OTHER DEDUCTIONS

AUTOMOBILE CLUB OF MICHIGAN

Year ended December 31, 1944

Commissions	\$ 135,775.77
Printing, stationery, and office supplies	225,998.25
Telephone and telegraph	70,354.18
Meetings of directors and department heads	1,348.38
Traveling	30,311.61
Automobile expense	9,536.57
Dues and memberships	295.00
Entertainment	2,074.71
Wartime personnel adjustment	3,000.00
Legal expense	409.45
Maps and guides	27,346.22
License expense	700.84
Ticket of expense	809.45
Emergency road service	592,912.60
Ponchos, hats, arm bands, etc.	13,458.99
Dinners, banquets, etc.	3,528.79
Postage and mailing	56,724.69
Cuts, maps, photos, etc.	7,193.46
Auditing	1,920.00
Insurance	8,089.42
Club emblems	1,244.38
AAA dues	55,776.00
Special representative	2,343.64
Safekeeping service	1,591.23
Signs	4,039.90
Employees' pension plan	38,663.15
Light, heat, and water	16,281.87
Advertising	10,244.27
Accident policy premiums	65,738.00
Radio broadcasts	31,994.83
Janitor supplies	5,048.28
Editorials	1,350.00
Agency discount	4,979.33
Miscellaneous	27,130.03
Amortization of leasehold improvements	8,226.62

\$1,466,439.91

Less portion charged to Detroit Automobile Inter-Insurance
Exchange

171,999.74

TOTAL \$1,294,440.17

(Here follows 1 Photolithograph, side folio 223)

✓ EXHIBIT 17

TAXPAYER'S INCOME AND DECLARED VALUE EXCESS PROFITS
TAX RETURN FOR 1945

1945

For the year beginning 1945 ending 1945

ANTONELLI CLUB OF MICHIGAN

139 Baylar Avenue

Detroit 26, Michigan

Business Automobile Club

Business group code number 35

9201311

Michigan

Cash Cash M.C.

Per Payment

GROSS INCOME			
1. Gross sales (where inventories are an income-determining factor)		Less: Returns and allowances	
2. Less: Cost of goods sold. (From Schedule A)			
3. Gross profit from sales			
4. Gross receipts (where inventories are not an income-determining factor)	2,353,345	16	
5. Less: Cost of operations. (From Schedule B)			
6. Gross profit where inventories are not an income-determining factor			2,353,345 16
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.			
8. Interest on corporation bonds, etc.	5,508.55	196.93	5,311 60
9. (a) Interest on United States savings bonds and Treasury bonds owned 12 months or longer (prior to March 1, 1945). (From Schedule C)	7,331.11	886.54	6,444 57
(b) Interest on Treasury bonds owned on or after December 1, 1945, and all other bonds owned on or after March 1, 1945, by the United States or any agency or instrumentality thereof. (From Schedule C)	33,309.87	13.92	33,295 95
10. Rents			39,956 48
11. Royalties			
12. (a) Excess of net short-term capital gain over net long-term capital loss. (From Schedule D)			
(b) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)			1,195 00
13. Total			

[fol. 224-225]

EXHIBIT 17—SCHEDULE K

SCHEDULE K—OTHER DEDUCTIONS

AUTOMOBILE CLUB OF MICHIGAN

Year ended December 31, 1945

Commissions	160,697.12
Emergency road service	875,279.60
Printing, stationery, and office supplies	232,183.83
Telephone and telegraph	79,942.38
Meetings of directors and department heads	2,117.95
Traveling	33,136.91
Automobile expense	14,994.98
Dues and memberships	597.00
Entertainment	2,530.10
Legal expense	953.18
Maps and guides	25,551.14
License expense	952.09
Ticket office expense	861.57
Ponchos, hats, arm bands, etc.	9,432.05
Dinners, banquets, etc.	2,877.97
Postage and mailing	59,501.02
Cuts, mats, photos, etc.	8,161.15
Auditing	2,160.00
Insurance	14,251.58
Club emblems	3,923.60
AAA dues	60,660.50
Special representative	2,371.55
Safekeeping service	1,715.43
Signs	1,884.66
Expense of unused real estate	2,034.92
Light, heat, and water	17,187.93
Accident policy premiums	56,018.46
Radio broadcasting	29,125.31
Detroit-Chicago Expressway expense	4,829.68
Janitor supplies	5,379.94
Editorials	1,680.00
Agency discount	6,327.99
Amortization of improvements to leased property	8,226.62
Miscellaneous	30,438.57
	<hr/>
	\$1,757,986.78
Less portion charged to Detroit Automobile Inter-Insurance Exchange	189,753.91
	<hr/>
TOTAL	<u>\$1,568,232.87</u>

(Here follows 1 Photolithograph, side folio 226)

EXHIBIT 19

TAXPAYER'S INCOME TAX RETURN FOR 1946

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES
CORPORATION INCOME TAX RETURN
For Calendar Year 1946

Page 1
1946

or fiscal year beginning, 1946, and ending, 1947

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

AUTOMOBILE CLUB OF MICHIGAN

(Name)

139 Bagley Avenue

(Street and number)

Detroit 26

(City or town, postal zone number)

Michigan

(State)

Kind of business: Automobile Club

Business group serial number
(from instruction N)

Number of places
of business 34

File Code 22

Serial No. 9

District 13

(Cashier's stamp)

Cash Check M. O.

First Payment

NORMAL-TAX NET INCOME COMPUTATION

Item and
Instruction No.

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor)	\$	Less: Returns and allowances	\$	\$
2. Less: Cost of goods sold. (From Schedule A)				
3. Gross profit from sales				\$
4. Gross receipts (where inventories are not an income-determining factor)			2,598,978.63	
5. Less: Cost of operations. (From Schedule B)				
6. Gross profit where inventories are not an income-determining factor			2,598,978.63	✓
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.				
8. Interest on corporation bonds, etc.	\$3,400.00	Less: Amortizable Bond Premium 159.36	3,240.64	✓
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to March 1, 1941. (From Schedule M, line 19 (a) (3) (iii))	2,919.59	322.20	2,597.39	✓
(b) Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 19 (a) (3) (ii))				
(c) Interest on Treasury bonds issued on or after December 1, 1941, and on obligations				

[fol. 227-228]

EXHIBIT 19—SCHEDULE K

SCHEDULE K—OTHER DEDUCTIONS

AUTOMOBILE CLUB OF MICHIGAN

Year ended December 31, 1946

Commissions	\$ 201,959.87
Emergency road service	851,729.69
Printing, stationery, and office supplies	288,638.24
Telephone and telegraph	97,024.20
Meetings of directors and department heads	2,255.99
Traveling	52,835.11
Automobile expense	16,443.77
Dues and memberships	482.78
Entertainment	2,912.82
Legal expense	167.00
Maps and guides	135,979.09
License expense	1,405.71
Ticket office expense	2,416.48
Ponchos, hats, arm bands, etc.	16,702.79
Dinners, banquets, etc.	3,530.43
Postage and mailing	60,278.57
Cuts, mats, photos, etc.	11,472.25
Auditing	3,497.39
Insurance	8,033.94
Club emblems	17,809.45
AAA dues	65,176.75
Special representative	2,585.11
Safekeeping service	1,581.49
Signs	2,815.34
Expense of real estate not used in operations	9,023.59
Light, heat, and water	15,809.14
Accident policy premiums	109,792.25
Radio broadcasting	25,613.75
Detroit-Chicago Expressway expense	6,478.47
Janitor supplies	6,431.94
Editorials	2,100.00
Agency discount	7,117.78
Amortization of improvements to leased property	8,226.62
Miscellaneous	30,526.09
	<u>\$2,068,763.89</u>
Less portion charged to Detroit Automobile Inter-Insurance Exchange	221,375.72
TOTAL	<u>\$1,847,388.17</u>

Note—Data required to be filed in connection with amounts contributed under a pension plan (Item 29b) was not completed when this return was filed, but will be presented upon completion.

Before The Tax Court of the United States 188A

EXHIBIT 20

TAXPAYER'S INCOME TAX RETURN FOR 1947

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES CORPORATION INCOME TAX RETURN For Calendar Year 1947

Page 1
1947

or fiscal year beginning _____, 1947, and ending _____, 1948

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

AUTOMOBILE CLUB OF MICHIGAN

(Name)

139 Bagley Avenue

(Street and number)

Detroit

26

Michigan

(City or town, postal zone number)

(State)

Kind of business: Automobile Club

Business group serial number
(from instruction IV)

Number of places
of business

34

File
Code

Serial
No.

2021

District

(Clerk's stamp)

Cash Check M. O.

First Payment

NORMAL-TAX NET INCOME COMPUTATION

Item and
Instruction No.

GROSS INCOME

1. Gross sales (where inventories are an income-determining factor)	\$	Less: Returns and allowances	\$	
2. Less: Cost of goods sold. (From Schedule A)				
3. Gross profit from sales				
4. Gross receipts (where inventories are not an income-determining factor)	\$2,849,504	94		
5. Less: Cost of operations. (From Schedule B)				
6. Gross profit where inventories are not an income-determining factor			2,849,504	94
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.				
8. Interest on corporation bonds, etc.	\$2,740.55	\$141.25	2,599	30
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to 1941 (From Schedule C)				

[fol. 230-231]

EXHIBIT 20—SCHEDULE K

SCHEDULE K—OTHER DEDUCTIONS

AUTOMOBILE CLUB OF MICHIGAN

Year ended December 31, 1947

Commissions	\$ 116,580.66
Emergency road service	885,960.07
Printing, stationery, and office supplies	335,250.55
Telephone and telegraph	101,316.24
Meetings of directors and department heads	2,787.76
Traveling	60,139.44
Automobile expense	19,769.00
Dues and memberships	575.50
Entertainment	2,503.12
Legal expense	884.73
Maps and guides	58,150.10
License expense	1,291.18
Ticket office expense	2,046.03
Ponchos, hats, arm bands, etc.	21,046.14
Dinners, banquets, etc.	8,819.55
Postage and mailing	55,885.68
Cuts, mats, photos, etc.	14,999.80
Auditing	3,495.72
Insurance	9,197.46
Club emblems	24,160.68
AAA dues	61,001.50
Special representative	2,833.67
Safekeeping service	1,561.64
Signs	5,055.75
Expense of real estate not used in operations	6,334.80
Light, heat, and water	19,066.05
Accident policy premiums	232,653.75
Detroit-Chicago expressway expense	7,000.55
Janitor supplies	7,485.10
Editorials	1,848.00
Agency discount	8,133.97
Amortization of improvements to leased property	7,149.40
Miscellaneous	38,718.35
	<hr/>
	\$2,123,701.94
Less portion charged to Detroit Automobile Inter-Insurance Exchange	271,225.63
	<hr/>
TOTAL	\$1,852,476.31

11. Royalties			
12. (a) Excess of net short-term capital gain over net long-term capital loss. (From Schedule C)			
(b) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)			
13. Dividends. (From Schedule E)		1.195	00
14. Other income. (State nature)	Schedule attached	74.319	18
15. Total income in items 3, and 6 to 14, inclusive			2,513.867 94
DEDUCTIONS			
16. Compensation of officers. (From Schedule F)		36.086	23
17. Salaries and wages (not deducted elsewhere)		678.667	51
18. Rent		83.881	61
19. Repairs		21.718	52
20. Bad debts. (From Schedule G)		210	84
21. Interest		906	23
22. Taxes. (From Schedule H) (Do not deduct sales taxes paid on or after 3-1-41)		24.978	15
23. Contributions or gifts paid. (From Schedule I)		1,879	97
24. Losses by fire, storm, shipwreck, or other casualty, or theft. (Submit schedule)			
25. Depreciation. (From Schedule J)		14,971	26
26. Depletion of mines, oil and gas wells, timber, etc. (Submit schedule)			
27. Net operating loss deduction. (Submit statement)			
28. Amortization of emergency facilities. (Submit schedule)			
29. (a) Advertising		8,734	81
(b) Amounts contributed under a pension, annuity, stock bonus, or profit-sharing plan, etc.		38,723	26
(c) Other deductions authorized by law. (From Schedule K)		1,568,232	87
30. Total deductions in items 16 to 29, inclusive			2,478,991 26
31. Net income for declared value excess-profits tax computation (Item 15 minus Item 30)			34,876 68
32. Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 15 (a) (i) (ii))	8981.91		842 69
33. Excess of net long-term capital gain over net short-term capital loss. (From Schedule C)			
34. Total of lines 31, 32, and 33			35,719 37
35. Less: Declared value excess-profits tax			-0-
36. Net income			35,719 37
37. Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of lines 9 (a) and 32)			2,287 26
38. Adjusted net income			28,432 11
39. Less: Adjusted excess profits net income from Form 1121. (See instruction on page 8)			-0-
40. Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 38 minus item 39, above)		1.015	75
41. Normal-tax net income			27,416 36
TOTAL INCOME AND DECLARED VALUE EXCESS-PROFITS TAXES			
42. Total income tax (line 38 or 50, page 2, whichever is applicable)			
43. Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation			
44. Balance of income tax	Exemption claimed		
45. Total declared value excess-profits tax (line 8, page 2)	as set forth in		
46. Total income and declared value excess-profits taxes due	attached rider		NO TAX

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[fol. 232] ARGUMENT AND SUBMISSION—October 5, 1955
(omitted in printing)

IN UNITED STATES COURT OF APPEALS

JUDGMENT—Filed February 17, 1956

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

[fol. 233] (File Endorsement Omitted.)

[fol. 234] IN UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 12247

AUTOMOBILE CLUB OF MICHIGAN, Petitioner

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the Tax Court of the United States

OPINION—Decided February 17, 1956

Before ALLEN, McALLISTER and STEWART, Circuit Judges.

ALLEN, Circuit Judge. This case arises on petition to review a decision of the Tax Court of the United States sustaining a determination of deficiencies for the calendar years 1943 to 1947, inclusive, in the aggregate amount of \$447,445.44, \$161,184.43 being income taxes and \$286,261.01 being excess profits taxes. Petitioner was organized as a nonprofit corporation without capital stock or shares and has never paid dividends. The facts are not in dispute and

the questions presented are questions of law. The purposes of petitioner stated in its Articles of Association are the following:

To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First," as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign boarding of public highways; and to cooperate in any work or movement [fol. 235] which may tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

As found by the Tax Court:

During 1943 through 1947 the petitioner devoted most of its resources and efforts to the bettering of conditions for motorists and the promotion of proper laws relating to the use of the motor car, the promotion of travel and the use of the automobile for other modes of transportation. It engaged in the promotion of safety, the solution of traffic problems and the promotion of the formation of school boy patrols. It organized the school boy patrols in Michigan. To teachers in the schools it furnished textbooks dealing with the conduct and operation of school boy patrols. As a reward it annually took some of the patrol boys to Washington, D. C. Annually it conducted seminars in the University of Michigan to promote the education of school teachers in the state in driver training courses. Petitioner's safety and traffic and engineer departments made surveys throughout the State of Michigan at the request of various cities and communities and many of its proposals as to safety measures were adopted. Petitioner supplied to its members in Michigan and those affiliated with the American Automobile Association emergency road service. The petitioner published and furnished to each of its active members a magazine containing

news about travel and news about laws as they pertain to the use of automobiles. Maps and other touring information with reference to road conditions were also provided, as was assistance to the American Automobile Association in its designation or appointment of proper places for tourists to be housed and fed. The petitioner secured reservations for its members when traveling abroad and arranged for the shipping of their cars abroad. Petitioner also promoted and furnished gratis to various communities proper directional and stop signs. In its services the petitioner attempted to do for the motorist in a collective way that which he was unable to do as an individual.

The petitioner does not engage in or conduct any social activities.

Petitioner during 1934 had supplied the Commissioner with detailed information concerning its operations, its financial assets and liabilities, and its receipts and dis- [fol. 236] bursements. On June 11, 1934, the Commissioner wrote petitioner that on the basis of evidence submitted petitioner was entitled to exemption under the provisions of Section 101 (9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that, therefore, it was not required to file returns for 1933 and prior years, and that under the provisions of Section 101 (9) of the Revenue Act of 1934 it would not be required to file returns so long as there was no change in its organization, its purposes or methods of doing business.

On July 5, 1938, after submission by petitioner of the information required concerning its claim for exemption under Section 101 (9) of the Revenue Act of 1936, the Commissioner wrote petitioner advising it that "since it appeared that there had been no change in its form of organization or activities which would affect its status, the previous ruling of the Bureau holding it to be exempt from filing returns of income was affirmed under the Revenue Act of 1936."

In May, 1945, the Commissioner wrote petitioner that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations from Federal

income taxation in light of the opinion of the Chief Counsel of the Bureau of Internal Revenue as set forth in G. C. M. 23688, C. B. 1943, 283. After petitioner had furnished certain further information, the Commissioner again wrote petitioner on July 16, 1945, calling attention to the fact that Section 101 (9) of the Internal Revenue Code provides for the exemption of

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

The Commissioner's communication continued as follows:

"This office holds that the term 'club' as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term 'club.'"

"The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering [fol. 237] of commercial services to your members.

"It is, accordingly, held that you are not a club 'organized and operated exclusively for pleasure, recreation and other nonprofitable purposes,' within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

"Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

"In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1,

		Less: Amortizable Bond Premium		
8.	Interest on corporation bonds, etc.	\$3,400.00	\$159.36	3,240.64 ✓
9.	(a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to March 1, 1941. (From Schedule M, line 19 (a) (2) (iii))	2,919.59	322.20	2,597.39 ✓
	(b) Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 19 (a) (2) (ii))			
	(c) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Schedule M)	34,610.67	13.92	34,596.75 ✓
10.	Rents			58,567.52
11.	Royalties			
12.	(a) Excess of net short-term capital gain over net long-term capital loss. (From Schedule C)			
	(b) Excess of net long-term capital gain over net short-term capital loss. (From Schedule C)			
	(c) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)			
13.	Dividends. (From Schedule E)			
14.	Other income. (State nature)			99,205.93
15.	Total income in items 8, and 6 to 14, inclusive			2,792,186.86
DEDUCTIONS				
16.	Compensation of officers. (From Schedule F)			37,855.70
17.	Salaries and wages (not deducted elsewhere)			802,744.15
18.	Rent			102,821.36
19.	Repairs			32,708.40
20.	Bad debts. (From Schedule G)			416.75
21.	Interest			
22.	Taxes. (From Schedule H)			28,581.84
23.	Contributions or gifts paid. (From Schedule I)			
24.	Losses by fire, storm, shipwreck, or other casualty, or theft. (Submit schedule)			
25.	Depreciation. (From Schedule J)			15,920.16
26.	Depletion of mines, oil and gas wells, timber, etc. (Submit schedule)			
27.	Net operating loss deduction. (Submit statement)			
28.	Amortization of emergency facilities. (Submit schedule)			
29.	(a) Advertising			9,871.06
	(b) Amounts contributed under a pension, annuity, stock bonus, or profit-sharing plan, etc.			48,020.08
	(c) Other deductions authorized by law. (From Schedule K)			1,847,388.17
30.	Total deductions in items 16 to 29, inclusive			2,927,580.41
31.	Net income (item 15 minus item 30)			\$130,393.55
32.	Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of items 9 (a) and (b))			2,751.55
33.	Adjusted net income			\$133,145.10
34.	Less: Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 33, above)			
35.	Normal-tax net income			\$133,145.10
TOTAL INCOME TAX				
36.	Total income tax (line 19, page 3)			
37.	Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation			
38.	Balance of income tax due	Exemption claimed as set forth in attached rider		
				No tax

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7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.				
8. Interest on corporation bonds, etc.	\$2,740.55	\$141.25	2,599	30
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of \$5,000 issued prior to March 1, 1941. (From Schedule M, line 19 (a) (3) (iii))	1,454.13	80.55	1,373	58
(b) Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 19 (a) (3) (ii))				
(c) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Submit schedule)	34,526.83	13.92	34,512	91
10. <i>Rents</i>			48,756	48
11. Royalties				
12. (a) Excess of net short-term capital gain over net long-term capital loss. (From Schedule C)				
(b) Excess of net long-term capital gain over net short-term capital loss. (From Schedule C)			13,952	42
(c) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)				
13. Dividends. (From Schedule E)			103,166	72
14. Other income. (State nature)				
15. Total income in items 3, and 8 to 14, inclusive				8,053,866 35
DEDUCTIONS				
16. Compensation of officers. (From Schedule F)			37,915	00
17. Salaries and wages (not deducted elsewhere)			912,317	04
18. Rent			121,949	30
19. Repairs			60,162	98
20. Bad debts. (From Schedule G)				
21. Interest				
22. Taxes. (From Schedule H)			37,143	94
23. Contributions or gifts paid. (From Schedule I)				
24. Losses by fire, storm, shipwreck, or other casualty, or theft. (Submit schedule)				
25. Depreciation. (From Schedule J)			41,553	84
26. Depletion of mines, oil and gas wells, timber, etc. (Submit schedule)				
27. Net operating loss deduction. (Submit statement)				
28. Amortization of emergency facilities. (Submit schedule)				
29. (a) Advertising			14,282	28
(b) Amounts contributed under a pension, annuity, stock bonus, or profit-sharing plan, etc.			50,274	95
(c) Other deductions authorized by law. (From Schedule K)			1,852,476	31
30. Total deductions in items 16 to 29, inclusive				3,128,075 73
31. Net income (item 15 minus item 30)				74,209 38
32. Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of items 9 (a) and (b))			1,373	58
33. Adjusted net income				75,582 5
34. Less: Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 33, above)				
35. Normal-tax net income				75,582 56
TOTAL INCOME TAX				
36. Total income tax (line 19, page 3)				
37. Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation				
38. Balance of income tax due				

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1943. You are, however, required to file returns for the year 1943 and subsequent years."

In compliance with this communication petitioner filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest, on the ground that it was exempt from taxes, and filed a petition to review the determination of the Commissioner. During the trial before the Tax Court petitioner admitted that it was taxable "for the period subsequent to July 16, 1945," but contended that the Commissioner acted arbitrarily and without authority in revoking previous rulings as to exemption, and in determining a deficiency in taxes for any period prior to July 16, 1945. In this court petitioner contends that the Commissioner in 1945 was estopped from retroactively revoking the prior determinations, made by a predecessor Commissioner, upon the ground that there had been no change in the law or in the character and operation of petitioner as a club.

The Commissioner ruled correctly in his determination of July 16, 1945, that petitioner was not exempt from tax under Section 101 (9), Internal Revenue Code. The statute plainly applies, as decided in G. M. C. 23688, not to any and all organizations in which no dividends are declared, but to "clubs," namely, to organizations in which members commingle in fellowship. Also this section of the statute applies, not to every kind of club, but to clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes. Since petitioner performs commercial services for its members it is not the kind of organization defined in [fol. 238] the statute. The right to exemption which arises under Section 101 (9), as it is created by statute, cannot be modified by the regulations. Since petitioner did not fall within the exemption provision it was at no time exempt from taxation, but was excused from taxation by a legal error of the Commissioner. The requirement that petitioner file returns for the years 1943 and 1944 was therefore valid and proper and, since petitioner was not required to file returns for a number of preceding years, it cannot be claimed that the ruling was arbitrary and oppressive.

As to the question of estoppel, petitioner does not assert that it has altered its position to its detriment in reliance on

the former rulings of the Commissioner. In default of proof to that effect estoppel does not enter into the case.

Petitioner urges that *H. S. D. Company v. Kavanagh*, 191 Fed. (2d) 831 (C. A. 6), and *Woodworth v. Kales*, 26 Fed. (2d) 178 (C. A. 6), require reversal of the Tax Court's decision. In the *H. S. D. Company* case the District Court, which had upheld the Commissioner in changing a ruling as to the exemption from taxation of contributions to two employees' trusts, was reversed by this court. We held that the Commissioner under the facts of that case was bound by the previous rulings of his predecessor determining that contributions to the employees' trusts were exempt from taxation. The court pointed out that the reasons for the successor Commissioner's action involved no new facts and no mistake of law, but only different inferences from the same facts. We there cited with approval an opinion by Judge Raymond, *Boyne City Lumber Company v. Doyle*, D. C. Mich., 47 Fed. (2d) 772, which declared that it is "an insupportable principle to say that such a determination of value may be reopened by each succeeding Commissioner, or by the same Commissioner, because a review of the same facts results in a difference or change of opinion." In *Woodworth v. Kales*, *supra*, this court held that, where income tax was assessed under a ruling approved by the then Commissioner of Internal Revenue, a succeeding Commissioner was without authority, upon re-examination of the same evidence to revoke such assessment and reassess an additional tax. The court concluded that there was no statutory authority for the right to reopen and re-examine the question of the 1913 fair value of the stock involved and "then, upon a re-examination of the same evidence, to reach a different result, flowing not from the discovery of any fraud or mistake, clerical or otherwise; in any fundamental fact [fol. 239] or matter of law, but resulting only from a 'more matured judgment.' " These cases do not, however, support petitioner's contention. In the *Kales* case the court declared that the Commissioner's "mistake of law will often, or usually, justify a revision of his conclusion." In the *H. S. D. Company* case we pointed out that the facts involved "no mistake of law, but only different inferences from the same facts." The Commissioner is not bound by his own or his

predecessor's prior mistakes of law. *Chattanooga Automobile Club v. Commissioner of Internal Revenue*, 182 Fed. (2) 551 (C. A. 6); *Austin Company v. Commissioner of Internal Revenue*, 35 Fed. (2d) 910 (C. A. 6); *Keystone Automobile Club v. Commissioner of Internal Revenue*, 181 Fed. (2d) 402 (C. A. 3); *Smyth v. California State Automobile Association*, 175 Fed. (2d) 752 (C. A. 9), certiorari denied 338 U. S. 905. Cf. *Langstaff v. Lucas*, 9 Fed. (2d) 691, affirmed per curiam 13 Fed. (2d) 1022 (C. A. 6), certiorari denied 273 U. S. 721.

That the ruling of July 16, 1945, corrected a mistake of law cannot be disputed. The principal question was the legal significance of the word "club" in Section 101 (9) of the Internal Revenue Code. Another legal question was, if petitioner was a club in which its members commingled in fellowship, whether the organization and operation were exclusively for pleasure, recreation, and other nonprofitable purposes. The earlier Commissioners by their erroneous construction of the statute had made mistakes of law which were subject to correction by the later Commissioner.

Petitioner also claims that, irrespective of the decisions in the *H. S. D. Company* and the *Kales* cases, *supra*, it is entitled to exempt status under the doctrine of *Helvering v. R. J. Reynolds Tobacco Company*, 306 U. S. 110. This is on the theory that the Treasury Regulations 111, Section 29.101-1, and previous corresponding Regulations provided in substance that when an organization has established its right to exemption it need not thereafter make a return of income or any further showing with respect to its status unless it changes the character of its operations or the purpose for which it was originally created. An amendment made to the Regulations later in 1944 contained substantially the same provision. Congress enacted a number of Internal Revenue statutes during this period to which the Treasury Regulations cited apply, but Congress did not alter or change the law so as to affect these Regulations. Petitioner therefore claims that the Regulations cited, under the authority of the *Reynolds* case, *supra*, constituted [fol. 240] a rule of law which cannot be changed by a subsequent determination of the Commissioner.

In the *Reynolds* case the Supreme Court ruled that the

gain secured by a corporation in the sale of its own stock in 1929 should be governed by the regulation in force in 1929, rather than by an amendment adopted by the Treasury in 1934, which made sales by a corporation of shares of its own capital stock subject to tax under certain circumstances. The Supreme Court refused to permit retroactive application of the Treasury amendments of 1934.

The Tax Court differentiated the *Reynolds* case from the instant one upon the ground that the Regulations there involved provided that a corporation realizes no gain or loss from the sale of its own stock and hence were legislative in character, while the Regulations here involved, Section 29.101-1 of Regulation 111, were administrative only.

In addition to this valid distinction between the *Reynolds* case and that presented herein we think a cogent answer to petitioner's contention is that upon this branch of the case it proceeds from its false premise that it established the right to exemption in 1934-1936, long before July 16, 1945, when the Commissioner revoked his previous ruling. Petitioner never had that right. If it had actually established such a right, the Commissioner could not rightfully revoke it, yet petitioner does not contest the Commissioner's right of revocation. The fact that the Commissioner in his earlier rulings misinterpreted the statutory meaning of the term "club" and ignored the circumstance that the service rendered petitioner's members were purely commercial, does not demonstrate that petitioner established a right to exemption. It demonstrates that the Commissioner made a mistake of law which under the weight of authority he was entitled to correct. *Chattanooga Automobile Club v. Commissioner of Internal Revenue, supra*; *Keystone Automobile Club v. Commissioner of Internal Revenue, supra*; *Smyth v. California State Automobile Association, supra*.

The retroactive ruling of the Commissioner ordering that tax returns be filed for 1943 and 1944 was authorized under Section 3791(b) of the 1939 Code. This section reads as follows:

Retroactivity of regulations or rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to

[fol. 241] the internal revenue laws, shall be applied without retroactive effect.

This provision clearly vests the Secretary or the Commissioner acting with approval of the Secretary; with the discretionary power to prescribe the extent, "if any," to which the ruling of the Commissioner shall or shall not be retroactive. The phrase "if any," authorizes the Secretary or the Commissioner acting with the approval of the Secretary to withhold retroactivity for the entire period involved or for any part thereof. In the instant case, if the Commissioner's ruling of July 16, 1945, were given full retroactive effect, it would require return of income taxes between the years 1934 and 1945. The Committee Reports of the House of Representatives, in recommending enactment of the predecessor section of the 1934 Act, pointed out that "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application. . . ." (House Report No. 704, 73rd Congress, 2d Section, page 38). The report then goes on to state that the cases involving rulings with reference to past transactions which have been closed by taxpayers in reliance upon existing practice, in some cases will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results, by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. This legislative history supports the above construction of Section 3791 (b).

Under the established principle that the greater power includes the less, this statute conferred authority upon the Treasury officials named to make the ruling of July 16, 1945, retroactive for only part of the period involved and for only two of the thirteen years. We conclude that this action was in no way arbitrary. The taxpayer was not misled nor has it shown that any unusual hardship resulted from the Commissioner's action.

Petitioner next urges that the statute of limitations bars assessment of the deficiencies asserted, contending that the period of limitations commenced to run from March 15, 1944, and March 15, 1945, when the 1943 and 1944 returns were due. If this is true, the assessment is barred. Ordi-

narily the three-year statute of limitations begins to run from the date that the return is filed, which date was October 22, 1945. If this date controls, the assessment is not barred. Section 275 (a) I. R. C. Petitioner claims that it was under no duty to file a return and that in such case the three-year [fol. 242] statute of limitations starts running from the date the return should have been filed if there had been a duty to file it. *Balkan National Insurance Company v. Commissioner of Internal Revenue*, 101 Fed. (2d) 75 (C. A. 2).

In this connection the chronology of the proceedings is important. The rulings of exemption were revoked on July 16, 1945. Petitioner was ordered to file 1943 and 1944 returns and these returns were filed October 22, 1945. The parties on August 25, 1948, executed consents that the income and excess profits taxes could be assessed on or before June 30, 1949, and on May 23, 1949, executed similar consents that the income and excess profits taxes could be assessed on or before June 30, 1950. The notice of deficiency was mailed to petitioner February 20, 1950.

Petitioner's assertion that his returns were due in March, 1944, and March, 1945, ignores the fact that Section 276 (a) provides that in the case "of a failure to file a return the tax may be assessed . . . at any time."

The Commissioner relies upon this statute and points out that petitioner failed to file the returns for 1943 and 1944 until three months after July 16, 1945. Petitioner answers that it was entirely blameless in its failure to file upon the due dates because its inaction was caused by the Commissioner. But when on July 16, 1945, the Commissioner expressly required petitioner to file returns, petitioner was under an obligation to file them as ordered. The delay in filing for more than three months was not induced by the Commissioner. Moreover, petitioner voluntarily agreed twice to extension of time for the assessment of the tax. This was not induced by the Commissioner.

The returns made upon Form 990 did not constitute the returns contemplated by Section 275 (a), namely, return of income taxes. They were not appropriate for the computation or assessment of income or excess profits taxes. As held by the Tax Court, they did not contain the data necessary to enable the Commissioner to compute petitioner's liability.

Two taxes were involved here, income and excess profits taxes for 1943 and 1944. The returns on Form 990 for each year were not the returns required of corporations under Section 52 (a) of the Internal Revenue Code. The contention that where two returns are required one return answers the purpose was dismissed by the Supreme Court of the United States as having no merit in *Commissioner of Internal Revenue v. Lane-Wells Co.*, 321 U. S. 219. We conclude that under this record the assessment was not barred by Section 275 (a).

[fol.243] The determination that membership dues received by petitioner should be included in the return of income for the year in which they were received was clearly correct. *E. H. Sheldon & Company v. Commissioner of Internal Revenue*, 214 Fed. (2d) 655, 656 (C. A. 6); *S. Loewenstein & Son v. Commissioner of Internal Revenue*, 222 Fed. (2d) 919 (C. A. 6); *Spencer White & Prentiss, Inc., v. Commissioner of Internal Revenue*, 144 Fed. (2d) 45 (C. A. 2), certiorari denied 323 U. S. 780; *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 424; *Security Flour Mills Company v. Commissioner of Internal Revenue*, 321 U. S. 281; *United States v. Lewis*, 340 U. S. 590. In this case the Supreme Court stated "The 'claim of right' interpretation of the tax laws has long been used to give finality to that [the accounting] period, and is now deeply rooted in the federal tax system. . . . We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer."

In conclusion the Tax Court correctly decided the issue as to depreciation deductions. Petitioner relies upon two General Counsel Memoranda, Nos. 10857 and 27491, as requiring that a different formula for depreciation deduction be applied from that used by the Commissioner. These memoranda have no bearing here. They come into force only where a petitioner is shown at some time during its existence to have been an organization exempt from taxation. As previously shown, petitioner was at no time exempt.

The decision of the Tax Court is affirmed.

McALLISTER, Circuit Judge, dissenting. While cheerfully acknowledging the persuasiveness of the excellent opinion

of Judge Allen, it appears to me that the decision of the Tax Court should be reversed for the reason that I consider the Commissioner's revocation of petitioner's tax-exempt status, with retroactive effect, to be inequitable. A summary of the facts may clarify the conclusion that I think should follow.

The record discloses that in May, 1934, the Commissioner of Internal Revenue, in reply to petitioner's written claim to exemption from federal income tax, requested evidence in support of its claim. This evidence was submitted in writing by petitioner and consisted of a detailed explanation of its activities, the sources from which its income was derived, the disposition it made of its income, and facts with respect to its capital stock, dividends, and all other relevant [fol. 244] facts relating to its activities. It disclosed that its income came from dues paid by the members of the club and the sale of advertising in a monthly magazine published by it; that no dividends or interest were paid on capital stock, and that, in fact, the club had no capital stock. The evidence submitted to the Commissioner further disclosed that the club charged no entrance or initiation fees and that its activities were composed of touring service, including logs, road maps, general touring information to members, and emergency road service, such as starting of members' disabled cars on the road, towing them to official club garages, changing tires, and such similar services. Moreover, the club disclosed that it was interested in safety activities and that several men were employed by the club for work in the public schools as well as work in cooperation with the various cities of the State of Michigan to promote safety and improve traffic conditions. In addition, the club cooperated in all work or improvement which might tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

After considering this evidence, the Commissioner wrote the club on June 11, 1934, stating:

"Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation. . . . it is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections

of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business."

More than three years later, on September 29, 1937, the Commissioner sent the club a questionnaire and requested it to supply certain information concerning its claim for exemption under Section 101(9) of the Revenue Act of 1936. The club filled in the questionnaire, signed it, and returned it to the Commissioner, with a letter dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936. Thereafter, the Commissioner again determined that the club was tax-exempt under the Revenue Act of 1936, as it had been under the Revenue Act of 1932 and all prior revenue acts, and so notified the club by a letter dated July 5, 1938, in which the Commissioner stated:

[fol. 245] "Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.

"Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936."

Seven years later, on May 12, 1945, a new Commissioner wrote the club, stating:

"Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103 (9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed

July 5, 1938, under the provisions of the Revenue Act of 1936.

"The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto"

The Commissioner's letter further requested the club to submit evidence similar to that which it had already submitted on several occasions.

The club, in reply to the request of the Commissioner, thereafter submitted the information requested, which was, in all important particulars, the same as that which it had repeatedly furnished during the prior eleven years.

Upon receipt of this information, the new Commissioner made a determination based upon the same facts, law, and regulations as were in effect during the prior determinations, to the effect that the tax-exempt determinations of the prior Commissioner were erroneous and, accordingly, retroactively revoked the club's tax-exempt status by letter of July 16, 1945, which stated:

[fol. 246] "Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed [by the Chief Counsel of the Bureau of Internal Revenue].

"Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

"The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of

safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members."

The above evidence which the Commissioner referred to as "the information recently submitted by you" was exactly the same evidence that had been submitted by the club eleven years before.

The above letter from the Commissioner continued:

"Section 101(9) of the Internal Revenue Code provides for the exemption of:

'Clubs organized and operated exclusively for pleasure, recreation, and other nonproftable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.'

"Prior revenue acts carry similar provisions.

"This office holds that the term 'club' as used in the above section of the law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term 'club'.

"The evidence submitted shows that fellowship does not constitute a material part of the life of your [fol. 247] organization and that your principal activity is the rendering of commercial services to your members.

"It is, accordingly, held that you are not a club 'organized and operated exclusively for pleasure, recreation and other nonproftable purposes', within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

"Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

"In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years."

This ruling dated July 16, 1945, therefore, retroactively revoked the Club's tax-exempt status for the two prior years of 1943 and 1944.

The Commissioner's retroactive revocation of petitioner's tax-exempt status is, in my opinion, invalid.

In *Rock Island, A. & L. Railroad Co. v. United States*, 254 U. S. 141, 143, Mr. Justice Holmes made the often quoted statement that "Men must turn square corners when they deal with the Government"; but, subsequently, referring to this observation, Judge McDermott, of the Tenth Circuit, in *Howbert v. Penrose*, 38 F. 2d 577, 581, added that "the government ought to turn square corners when dealing with its citizens." That policy has, apparently, heretofore been followed by the Commissioner of Internal Revenue. Thus, in an article, "Taxpayer's Rulings," in 5 *Tax Law Review*, page 115 (1950), Mr. J. P. Wenchel, formerly Chief Counsel of the Bureau of Internal Revenue, stated that, with exceptions not here relevant, "the policy of not disturbing a ruling once it has been issued, is now strongly ingrained in the administrative practice of the Bureau. Rulings are not issued indiscriminately, hypothetically, or for a useless purpose, and once issued they can be acted upon with reliance. This policy of fair play, which has been the unvarying policy of the Bureau for a decade and more, is so strong that even where a Supreme Court decision changes the Bureau's previous interpretation of the law, and such change operates to the benefit of the [fol. 248] Government, the Bureau at times has not applied such changes retroactively to the detriment of taxpayers, including those who did not ask for a ruling. Much water has gone over the dam since the Couzens case [James Couzens, 11 B. T. A. 1040 (1928)]. Taxpayers may find it more difficult to procure Bureau rulings than in those days, but once obtained, they can rely upon the Bureau's sense

of fairness, and proceed to carry out their transactions knowing that they will not be faced with a later assessment contrary to what had been expected."¹

The foregoing policy would seem to have been confirmed by a Revenue Ruling,² issued by the Commissioner, strangely enough, after his revocation of petitioner's tax-exempt status, and after the decision of the Tax Court in this case, in the following language: "It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment." This professed policy of the Commissioner of Internal Revenue of not revoking his ruling once it had been acted upon, is consonant with the view of this court, not merely as to proper policy to be pursued, but as to the governing law, which has, for many years, been repeatedly and consistently followed in the decision of cases coming before it.

In *Woodworth v. Kales*, 26 F. 2d 178 (C. C. A. 6), in an opinion written for the court by Judge Denison, it was held that a new Commissioner is without authority to revoke the determination of a former Commissioner and reassess an additional tax based upon what appears to him to be a better judgment of the matter, if there are no newly discovered facts, no fraud or mistake, clerical or otherwise,

¹ In the above article, the author defined the term, "taxpayer's ruling," as used therein, "to denote a statement in writing, normally in letter form, by the Commissioner of Internal Revenue or a Deputy Commissioner, setting forth the position of the Bureau with respect to a specific tax problem or problems of a specific taxpayer or taxpayers. Revenue agents and other representatives of the Bureau often give oral advice to taxpayers, but taxpayers cannot rely with impunity upon such representations or statements."

² Revenue Ruling 54-164, 1954-1 C. B. 88, 91 (originally issued as I. R. Mimeograph No. 54-73, dated April 28, 1954).

in any fundamental fact or matter of law. See also *Routzahn v. Brown*, 95 F. 2d 766, 771 (C. C. A. 6), and *H. S. D. Co. v. Kavanagh*, 191 F. 2d 831 (C.A. 6).

[fol. 249] In *Boyer City Lumber Co. v. Doyle*, 47 F. 2d 772 (D. C. Mich.), Judge Raymond stated that it was "unsupportable" to say that a determination of the value of the taxpayer's property could be reopened by each succeeding Commissioner because a view of the same facts resulted in a change of opinion, and it was held that the right to reopen such a determination depended upon the presence of a fraud, misrepresentation, or gross error. Further, in *Penrose v. Skinner*, 298 F. 335 (D. C. Col.) the court assumed that no one could contend that a succeeding Commissioner could overrule or ignore the decisions of his predecessor unless the decisions were erroneous in law or were tainted with fraud. The reasons for these views have been variously stated in different adjudications.

Courts have uniformly held that when the executive department of the government is charged with the execution of a statute, places a reasonable construction upon it, and acts upon that construction for a number of years, changes in the construction of the statute are looked upon with disfavor, when parties who have contracted with the government on the faith of the old construction may be injured thereby. *United States v. Alabama Great Southern Railroad Co.*, 142 U. S. 615; *Jacobs v. Pritchard*, 223 U. S. 200; *Whitebird v. Eagle-Picher Lead Co.*, 28 F. 2d 200 (D. C. Okla.), affirmed 40 F. 2d 479 (C. C. A. 10).

"If the language [of the statute] seemed to us doubtful (as it does not), the practically contemporaneous construction by the Treasury Department in its regulations would require us to exclude expenses incident to the organization of a corporation and the sale of its capital stock as being within the fair meaning of 'ordinary and necessary expenses incurred in carrying on the business' of such corporation." *Simmons Co. v. Commissioner of Internal Revenue*, 33 F. 2d 75, 76 (C. C. A. 1).

"Agencies do not enjoy a ruthless discretion to ignore their pasts. Like legislatures they must guard against illegal retroactivity. Like judges they are limited by res

judicata and influenced by stare decisis."³ See *National Labor Relations Board v. Guy F. Atkinson Co.*, 195 F. 2d 141, 150 (C. A. 9).

In this case, it is not claimed that the retroactive revocation was based upon any newly discovered facts, fraud, [fol. 250] or mistake, clerical or otherwise, in any fundamental fact. The one ground upon which the Commissioner contends that the retroactive ruling was proper and valid is that the former determination of the prior Commissioner was based upon a mistake of law, and that the succeeding Commissioner merely corrected this mistake.

That the prior rulings of the other Commissioners were based on a mistake of law, and, consequently, that the rulings can be revoked with retroactive effect, is the keystone of the Commissioner's argument in this case.

While the foregoing may be said to constitute the general rule, it is not every ruling based upon a mistake of law that may be afterward subject to so-called correction by the Commissioner, with retroactive effect. Where the construction of a statute by a former Commissioner has not been plainly erroneous, or in conflict with express statutory provisions, a succeeding Commissioner may not revoke the former ruling with retroactive effect.

"It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with *express* statutory provision." (Emphasis supplied.) *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349.

A construction of a statute made by the body charged with its enforcement, which has long been followed in practical execution, and has been impliedly sanctioned by the re-enactment of the statute without alteration in the particulars construed, must, *when not plainly erroneous*, be treated as read into the statute. *New York, N. H. and H. R. Co. v. Interstate Commerce Commission*, 200 U. S. 361, 401.

³ See article by Frank C. Newman, "Should Official Advice Be Reliable?" 53 *Columbia Law Review*, pages 374, 376.

"This presumption that the department charged with the execution of the law has properly interpreted it is strengthened in proportion to the length of time such construction has obtained without challenge by the law-making power, so that, where such executive construction has been long continued, a court has a right to presume that Congress is content therewith. This exhausts the full force and effect of such construction, and, while not binding upon a court, nevertheless a court will be slow to depart therefrom, unless the language of the statute itself absolutely requires it to do so." *Mayes v. Paul Jones & Co.*, 270 F. 121, 130 (C. C. A. 6).

[fol. 251] Where a statutory provision is ambiguous, and the executive department which must apply and enforce it declares a construction (not in itself ambiguous) for administrative purposes, and thereafter Congress re-enacts the provision without substantial change, the courts will accept that construction unless it be plainly erroneous. *Walker v. United States*, 83 F. 2d 103, 107 (C. C. A. 8).

Regulations promulgated by the Treasury Department relative to income taxes have the force and effect of law, when not in conflict with *express* statutory provisions. *Crocker v. Lucas*, 37 F. 2d 275 (C. C. A. 9).

The construction given to the statute in this case by the former Commissioners cannot be said to be plainly erroneous and in conflict with the express provisions of the statute. That construction had been followed for twenty-three years by the Treasury Department.⁴ The prior Commissioners had repeatedly asked for and received information from the taxpayer club and other automobile clubs with respect to every detail of their organization, activity, and characteristics; and had repeatedly held them to be tax-exempt under the provisions of the statute in question. When, finally, the last Commissioner "reconsidered," as he said, the status of automobile clubs and assessed taxes on

⁴ Automobile clubs were granted tax immunity by O. D. 643, 3 Cum. Bull. 241 (1920). That ruling was followed by G. C. M. 2867, VII-1 Cum. Bull. 115 (1928); G. C. M. 3555, VII-1 Cum. Bull. 117 (1928).

the ground that they were not within the statutory exemption because they were not a "social club" and that they were not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, the California State Automobile Association brought an action in the district court to recover overpayments of tax, and Judge Lemmon, now a member of the Court of Appeals of the Ninth Circuit, in a persuasive and comprehensive opinion in *California State Automobile Association v. Smyth*, 77 F. Supp. 131 (1948), held that the association was a club within the meaning of the statute, and that it was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes; thus sustaining the rulings of the prior Commissioners of Internal Revenue.

When the same question came before the Tax Court in *Chattanooga Automobile Club v. Commissioner*, 12 T. C. 967 (1949), although the majority of the court held that the club was not exempt from taxation, four of the judges, in two separate opinions, dissented on the ground that the [fol. 252] organization was a club within the meaning of the statute, and that it was organized and operated for a nonprofitable purpose.

It is true that the judgment of the district court in the Smyth case, *supra*, was reversed in *Smyth v. California State Automobile Association*, 175 F. 2d 752 (C. A. 9), in an able opinion written for the court by Chief Judge Denman, in which the statute was construed in the light of the doctrine of ejusdem generis, pursuant to which it was held that clubs "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes," in the language of the statute, meant that the "other nonprofitable purposes" must be concerned with pleasure and recreation. However, in a similar case, *Keystone Automobile Club v. Commissioner of Internal Revenue*, 181 F. 2d 402 (C. A. 3), Judge Goodrich, speaking for the court, in arriving at the same conclusion as the Court of Appeals of the Ninth Circuit to the effect that the club was not exempt from tax, rested his view on different grounds and expressly declined to construe the statute according to the doctrine of ejusdem generis, saying: "We have been treated to a good sized dose of so-called canons of construction known as noscitur

a sociis and ejusdem generis in connection with the argument. We find them just about as helpful in settling a specific case as those vials of distilled wisdom of the ages containing the phrases 'birds of a feather flock together' and 'a man is known by the company he keeps.' Throwing a vague phrase into law Latin does not make it any more useful in construing a statute." It may be noted that the opinion of the General Counsel of the Bureau of Internal Revenue, upon which the Commissioner revoked petitioner's tax-exempt status, was posited upon a construction of the statute according to the doctrine of *noscitur a sociis*.

The construction of the Act, in the opinion of Judge Goodrich, was based upon the fact that the statute set forth numerous types of organizations which were specifically exempted from taxation; and that the type represented by an automobile club was entirely different from those spoken of in the other paragraphs; that if the taxpayer automobile club's contention was right, Congress had thrown in a lot of unnecessary and confusing classifications in the other paragraphs of the section; and that it, therefore, appeared that Congress, in speaking of "clubs organized and operated exclusively for pleasure, recreation and other non-profitable purposes," was talking "about one type of organization among individuals which was, on the whole, different from the types talked about in the other paragraphs of this section." Judge Goodrich, however, pointed out that no attempt had been made to give retroactive effect to the ruling of the new Commissioner's revocation of the tax-exempt status of automobile clubs.

Both Judge Denman and Judge Goodrich, in the above cases, took notice of the place occupied by the automobile in the life of the country forty years ago and the evolution that had occurred since that time, with the suggestion that passenger cars in the early years were not used for commercial purposes, and that it may well have been that car owners in those days did club together for their common interests. At some time, this changed, and, as Judge Goodrich said, the Commissioner had the right to change his mind about the relative place of automobile owners in the scheme of things. It, therefore, may well have been the case that auto-

mobile clubs at one time were, without question, exempt from tax, and properly held so by the Commissioner. If so, it would seem inequitable that when a succeeding Commissioner arrived at the conclusion that the situation had changed, he could revoke the tax-exempt status he had determined upon for such clubs, with retroactive effect:

In *Chattanooga Automobile Club v. Commissioner of Internal Revenue*, 182 F. 2d 551, 554 (C. A. 6), Judge Martin, speaking for the court in affirming the action of the Tax Court in the Chattanooga case, *supra*, set forth the grounds for holding an automobile club not exempt from taxation in the following language:

"The petitioners contend that the words 'other non-profitable purposes' should not be construed as the Commissioner of Internal Revenue construed them to mean non-profitable purposes *similar* to purposes of pleasure and recreation. This argument overlooks the fact that preceding subsections of section 101 of the Internal Revenue Code specifically exempt nonprofit organizations operated for literary, educational, scientific, charitable, or religious purposes, chambers of commerce, business and civic leagues, and other specified eleemosynary institutions. Were the insistence of the petitioners accepted, many of these specific exemptions would be mere surplusage, inasmuch as they would fall within the sweep of the expression 'other non-profitable purposes' contained in subsection 9. We think the words 'other non-profitable purposes' carry [fol. 254] in the context a plain connotation that the purposes must be construed as coming within the same classification as pleasure and recreation. The services rendered by each club were in part to automobiles used for business purposes and, therefore, not operated 'exclusively' for pleasure, recreation, and other similar purposes."

As far as the power of the Commissioner to change the construction of a statute *with prospective effect* goes, Judge Martin, in the Chattanooga case, *supra*, quoted from *Hell-*

vering v. Wilshire Oil Co., 308 U. S. 90, 100, wherein the Supreme Court said:

"The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States v. Dakota-Montana Oil Co.* [288 U. S. 459, 466, 53 S. Ct. 120, 77 L. Ed. 893]) . . . does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers."

All of the above serves only to show clearly in what different lights the judges of the Tax Court, the district court, and the courts of appeals viewed the statute, even when they agreed in their conclusions, and that the interpretation and construction placed upon the statute during twenty-three years by succeeding Commissioners of Internal Revenue, who studied and examined all the various provisions of the Act, repeatedly, intently, and with specific application to the club in question, was a fair interpretation, and, certainly, not plainly erroneous or contrary to the express words of the statute. As such, it cannot be revoked by a succeeding Commissioner with retroactive effect.

It is conceivable, too, that the authorities cited by the government to sustain the changed view of the successor Commissioner, might have also sustained him if he had found it proper to construe the statute in the sense now contended for by the taxpayer. For administrative agencies designated by Congress as specialists in a particular field and advised by experts are, within a wide area, in a better position than a reviewing court to determine appropriate applications of statutes which they are directed to [fol. 255] administer. *National Labor Relations Board v. Medo Photo Supply Corp.*, 135 F. 2d 279 (C. C. A. 2). "The construction given to a statute by those charged with the duty of executing it is always entitled to the most respectful consideration, and ought not to be overruled without cogent reasons. . . . The officers concerned are usually able

men, and masters of the subject. Not infrequently they are the draftsmen of the laws they are afterwards called upon to interpret." *United States v. Moore*, 95 U. S. 760, 763.

What is the principle of law to be applied in such cases as the one before us? It is the rule that the doctrine of estoppel must be applied with great caution as against the government and its officials. Some courts have, however, applied general equitable principles to prevent inequitable governmental action, as in suits for refunds, and this doctrine has been denominated "quasi estoppel" by some authorities.

As to estoppel against the government, that principle is summed up in *Ritter v. United States*, 28 F. 2d 265 (C. C. A. 3):

"It is true . . . that when the sovereign becomes an actor in a court of justice, its rights must be determined upon those fixed principles of justice which govern between man and man in like situations. . . . The acts or omissions of the officers of the government, if they be authorized to bind the United States in a particular transaction, will work estoppel against the government, if the officers have acted within the scope of their authority."

In *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co. et al.*, 284 U. S. 370, it was held that where the Interstate Commerce Commission had, upon complaint and after hearing, declared what was the maximum reasonable rate to be charged by a carrier, it may not, at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission then held it should have decided in the earlier proceeding, by declaring its own prior finding as to reasonableness to be erroneous. In passing upon the case, the court said: "The Commission's error arose from a failure to recognize that when it prescribed a maximum reasonable rate for the future, it was performing a legislative function, and that when it [fol. 256] was sitting to award reparation, it was sitting for a purpose judicial in its nature. In the second capacity,

while not bound by the rule of *res judicata*, it was bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect. It could repeal the order as it affected future action, and substitute a new rule of conduct as often as occasion might require, but this was obviously the limit of its power, as of that of the legislature itself."

In *Stockstrom v. Commissioner of Internal Revenue*, 190 F. 2d 283 (C. A. D. C.), it appeared that the taxpayer did not file gift tax returns in 1938 on a transfer to a trust because, under the Commissioner's interpretation, such gifts were of present interests and entitled to a \$5,000 exemption. The omission to file was approved in 1941. However, in 1948, following a Supreme Court decision, the Commissioner decided that the transfers in 1938 were taxable, and he, therefore, assessed a deficiency. The case went off on the question of whether the statute of limitations barred the deficiency assessment. Obviously, if a return had been filed, the deficiency assessment would have been barred. The court held that the Commissioner lacked authority to make the assessment. The holding was put on the ground that one may not found a claim upon an omission which he himself induced. In this regard, the court quoted from Mr. Justice Cardozo in *Stearns Co. v. United States*, 291 U. S. 54: "The applicable principle is fundamental and unquestioned. 'He who prevents a thing from being done may not avail himself of the non-performance which he has himself occasioned, for the law says to him in effect: "This is your own act, and therefore you are not damnified." ' . . . Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. . . . A suit may not be built on an omission induced by him who sues." The court in the *Stockstrom* case, *supra*, continued: "It has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the

Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, [fol. 257] when the Commissioner himself was responsible for that failure." See also the scholarly and comprehensive opinion of Judge Mathes in *Smale & Robinson, Inc. v. United States*, 123 F. Supp. 457 (D. C. Cal.):

The taxpayer did not have notice, as claimed herein by the Commissioner, during 1943 and 1944, of the pending revocation of its exemption rulings. The Commissioner contends that it had such notice as a result of the opinion expressed in the General Counsel's Memorandum No. 23688, issued in 1943. That memorandum involved the American Automobile Association, which was an organization consisting of other incorporated clubs, and having rules against membership of any individuals. The memorandum held that the term, "club," contemplated individual members and not an association composed entirely of artificial members; and then, although it had no relation to the organization in question, the memorandum went on to say that even if there were individual members, the organizations would not qualify as clubs because there was not a commingling of members in fellowship. Such opinion of the General Counsel, issued in the case of a club composed of a number of corporate clubs, was not notice to petitioner herein of revocation of its tax-exempt status as of the time that the opinion was issued. As a matter of fact, in the Commissioner's letter to the club in 1945, he did not even then notify it of the revocation of its exemption from tax, and had not, at that time, decided to do so. The Commissioner's letter merely informed the taxpayer that the Bureau was reconsidering the question of exemption "in the light of the opinion of the Chief Counsel," and asked for the filing of a questionnaire—consisting of the same information the Commissioner already had in his files from this taxpayer. It is difficult to see how it could be maintained that the taxpayer had notice of the pending revocation of its tax-exempt status in 1943 as a result of the issuance of the Chief Counsel's opinion, when in 1945, the Commissioner first notified the taxpayer that he was only proceeding to take the matter under advisement and to reconsider, at that time, the tax-exempt status of the club. Petitioner had es-

established its own tax-exempt status in accordance with Article 101-1 of Regulation 94,⁵ in force during 1938, sub-[fol. 258] mitting to the Commissioner the information required by such regulation. Substantially the same provisions were contained in the regulations in force during 1934 when petitioner first submitted information to the Commissioner in obtaining the first ruling that it was exempt from taxation.

As to Section 3791(b) of the Internal Revenue Code, it would not seem to apply when the Commissioner does not have the power to make a retroactive ruling; and it could hardly be contended that the Commissioner, in such a case as the one before us, had the power to revoke, with retroactive effect, a tax-exempt status theretofore acquired for any period he considered proper, whether for two years or twenty years. Congress had repeatedly, over a period of a quarter of a century, re-enacted Section 101(9) of the Internal Revenue Code, subsequent to the determinations of the various Commissioners that automobile clubs, and peti-

⁵ "Art. 101-1. PROOF OF EXEMPTION.—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. . . ." See also Section 29.101-1 of Treasury Regulation 111, promulgated under the Internal Revenue Code of 1939, as amended by T. D. 5381, 1944 Cum. Bull. 188, 189, and Section 29.101-2, as added by T. D. 5381, *supra*.

tioner club in particular, were tax-exempt. The Treasury's power to make retroactive amendments, changing Treasury regulations or decisions, may not be exercised where Congress has, by repeated re-enactments, given its sanction to the existing regulations. *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110. See *Studies in Federal Taxation*, Randolph E. Paul, Third Series, pages 420, et seq., Harvard University Press, 1940. The same principle is here applicable, and a succeeding Commissioner may not retroactively revoke the several prior determinations of his predecessors that petitioner is tax-exempt where Congress has, by repeated re-enactments of the pertinent provision of the statute, given its sanction to such prior determinations. As to the showing of hardship suffered by petitioner through retroactive revocation of its exemption from taxation, the fact that no reserves had been set up for such comparatively large tax for a two-year period, would seem to establish the prejudice that would be suffered by petitioner to its substantial injury, and if the Commissioner [fol. 259] had the right, as he claims, to revoke retroactively petitioner's tax exemption for a possible thirteen-year period, it might well result in complete insolvency of the taxpayer.

Petitioner relied in good faith on the rulings made by the Commissioner in 1934 and 1938 holding it exempt from taxation. In keeping with the instructions received in the ruling letters, petitioner did not file income tax returns, since no change had occurred in the organization of the club, its purposes, or activities; and in reliance upon the tax-exempt rulings, it did not, during 1943 and 1944, set up any reserve or make any other provision to cover the income and excess profits taxes later asserted by the Commissioner for those years. Petitioning club was operated, during 1943 and 1944, in all respects on the premise that it was exempt from taxation. As a result of the retroactive application of his 1945 ruling, the Commissioner asserted a deficiency in income and excess profits taxes for the years 1943 and 1944 in the amount of \$384,059.97.

Under the circumstances above set forth, it seems to me that it would be most inequitable to subject petitioner to payment of the deficiency claimed in this case as a result

of the retroactive revocation of its exemption from taxation—covering a period of a quarter of a century and resulting from repeated rulings of the Commissioners of Internal Revenue in that period. In my opinion, the decision of the Tax Court should be reversed.

[fol. 260] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 261] SUPREME COURT OF THE
UNITED STATES, OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE

Order Allowing Certiorari—Filed October 8, 1956

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(2589-0)

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HAROLD B. WILLEY, Clerk

IN THE
Supreme Court of the United States

OCTOBER TERM, 1955

No. ~~947~~ 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT
OF APPEALS FOR THE
SIXTH CIRCUIT

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1955

No.....

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

**PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT
OF APPEALS FOR THE
SIXTH CIRCUIT**

Automobile Club of Michigan prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in this case on February 17, 1956.

OPINIONS BELOW

The opinion of the Tax Court of the United States, entered September 23, 1953, is reported in 20 T. C. 1033. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, *infra*, pp. 4a-34a, is reported in 230 Fed. (2d) 585.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 17, 1956, and is set forth in Appendix C, *infra*, p. 35a. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

QUESTIONS PRESENTED

Three separate questions are presented for review:

I. Membership Dues

Was the petitioner, reporting on the accrual basis, entitled to report prepaid membership dues as income when earned, rather than when received, in accordance with the method of accounting regularly employed by petitioner in keeping its books?

II. Retroactive Revocation of Tax Exempt Status

Did the Commissioner of Internal Revenue in 1945 have authority to revoke with retroactive effect the rulings previously made by a predecessor Commissioner which held that petitioner was exempt from taxation, when there had been no change in the law or in the character and operation of the petitioner as a club?

III. Statute of Limitations

If the Commissioner of Internal Revenue had the power to revoke retroactively petitioner's previously established tax exempt status, did the statute of limitations bar the assessment of the deficiencies asserted for the years 1943 and 1944?

STATUTES INVOLVED

The pertinent statutory provisions are printed in Appendix A, *infra*, pp. 1a-3a.

STATEMENT

The basis of the jurisdiction of the Court of first instance, the Tax Court of the United States, was a petition filed by the taxpayer pursuant to section 272 of the Internal Revenue Code of 1939, for a redetermination of deficiencies asserted by the Commissioner of Internal Revenue for the calendar years 1943, 1944, 1945, 1946 and 1947.

The facts are not in dispute. The case with respect to each of the three questions is as follows:

Question I. Membership Dues

Petitioner, an automobile club rendering various services to its members, kept its books on a calendar year basis and upon the accrual method of accounting. Its chief source of revenue was from membership dues, which were received by petitioner in every month of the year. A member paid his dues, not for past services rendered, but for services to be rendered to him by petitioner during the 12-month period following the payment of the dues.

Under petitioner's accrual method of accounting, the dues received from a member were recorded in an account designated as "Unearned Dues". Each month, as the dues were earned, petitioner transferred one-twelfth of the member's dues from the "Unearned Dues" account to an account designated on its books as "Membership Income".

Thus, if a member paid his dues in December, 1945, petitioner's books recorded only one-twelfth of the dues as income for 1945, and eleven-twelfths of the dues were recorded as income for the year 1946. If a member resigned the unearned portion of his dues was refunded to him. The petitioner consistently followed this method of accounting which was adopted—many years before the revocation of petitioner's tax exempt status—upon the recommendation of its accountants as best reflecting its income.

Petitioner filed its income tax returns in accordance with its books, and included as income each year from dues the amounts credited to the "Membership Income" account. The Tax Court sustained the Commissioner's contention that under the "claim of right" doctrine the dues were income for tax purposes when received, rather than when earned. The Circuit Court of Appeals affirmed. It is petitioner's contention that the "claim of right" doctrine is inapplicable, and that it correctly reported the income from dues as earned in accordance with the method of accounting regularly employed in keeping its books.

Question II. Retroactive Revocation of Tax Exempt Status

Petitioner, incorporated under the laws of Michigan, was organized and has always operated as a non-profit organization. It has no capital stock and cannot pay dividends on earnings to its members, even in the event of its dissolution. On June 11, 1934, the Commissioner of Internal Revenue by a letter to petitioner ruled that petitioner was exempt from taxation under the provisions of section 103(9) of the Internal Revenue Act of 1932 and corresponding provisions of prior Revenue Acts. The ruling letter advised petitioner:

"You are not, therefore, required to file returns for 1933 and prior years and it follows that future

returns, under the provisions of section 101(9) of the Internal Revenue Act of 1934, will not be required so long as there is no change in your organization, your purpose or method of doing business."

It is conceded that the above ruling was based upon a complete disclosure by petitioner of the purpose for which it was organized and the manner in which it operated.

In 1938 the Commissioner of Internal Revenue again requested petitioner to submit data as to its right to exemption from tax. Upon receipt of all information requested of the petitioner, the Commissioner ruled, in a letter dated July 5, 1938, that petitioner was exempt from taxation under the Revenue Act of 1936, and specifically confirmed the previous ruling holding the petitioner to be exempt from filing income tax returns.

In 1945 a new Commissioner of Internal Revenue advised petitioner that the Bureau of Internal Revenue was reconsidering the exemption of automobile clubs, and requested petitioner to furnish data as to its purposes and manner of operation. After receipt of that information the Commissioner of Internal Revenue notified petitioner by a letter dated July 16, 1945 that petitioner was not exempt from taxation under section 101(9) of the Internal Revenue Code of 1939 or the corresponding provisions of prior Revenue Acts, and the Commissioner revoked the previous rulings given in 1934 and 1938. The Commissioner requested petitioner to file tax returns for 1943 and subsequent years.

The retroactive revocation in 1945 of the rulings received by petitioner in 1934 and 1938 was not based on any intervening change in the statute or in the manner in which petitioner conducted its activities, or on any misrepresen-

tation, concealment, or fraud on the part of the petitioner. The revocation was based on the lack of social activities between the members of the club. The prior Commissioner was aware of this lack of social activities when he issued tax exempt rulings to petitioner in 1934 and 1938.

Before the Tax Court, petitioner conceded that the Commissioner in 1945 could revoke with prospective effect the rulings previously given to taxpayer, but contended that the Commissioner was without authority to revoke those rulings with retroactive effect. The Tax Court held that the retroactive revocation was valid, and the Circuit Court of Appeals affirmed. In a dissenting opinion, Circuit Judge McAllister stated that the Commissioner in 1945 could not revoke the former rulings with retroactive effect. It is petitioner's contention that the dissenting opinion correctly states the law.

III. Statute of Limitations

The petitioner did not file income tax returns on the due dates for the years 1943 and 1944, in reliance upon the regulations and the two prior rulings of the Commissioner of Internal Revenue which advised the petitioner that having established its tax exempt status it was not required to file income tax returns. Returns for those years were filed under protest after the Commissioner in 1945 revoked petitioner's exempt status, and on the returns petitioner claimed its exemption from tax.

However, petitioner filed, for the calendar years 1943 and 1944, the annual information return (Form 990) required of certain tax exempt organizations under section 54(f) of the Internal Revenue Code of 1939. Petitioner's return on Form 990 for the calendar year 1943 was filed on August 12, 1944, and the return for the calendar year

1944 was filed on May 17, 1945. Attached to each of the returns was a statement of petitioner's gross income and receipts for the year, its disbursements, and a statement of its assets and liabilities. All the data and information requested of the petitioner was furnished the Commissioner.

Before the Tax Court, petitioner contended that the 3-year statute of limitations for the assessment of deficiencies commenced to run on the due dates for filing the returns for 1943 and 1944, since the Government itself induced and caused the petitioner not to file tax returns on the due dates. It is conceded that if the statute of limitations started to run on the due dates for the returns, the statute bars the assessment of any deficiency for the years 1943 and 1944.

Petitioner also contended before the Tax Court that the filing of the annual return on Form 990 commenced the running of the statute of limitations so as to bar the assessment of any deficiency for 1943 and 1944. The Tax Court held that the statute of limitations did not bar the assessment of deficiencies, and the Circuit Court of Appeals affirmed.

If Question II is resolved by a decision that the Commissioner's retroactive revocation of petitioner's tax exempt status was invalid, then Question III as to the statute of limitations becomes moot.

REASONS FOR GRANTING THE WRIT

I. On the question whether membership dues constituted income to petitioner when received or when earned:

A. There is a direct conflict among Circuits.

The decision of the Court of Appeals on the membership dues issue is in direct conflict with the decision of the Court of Appeals for the Tenth Circuit in *Beacon Publishing Company v. Commissioner*, (1955) 218 Fed. (2d) 697, and with the decision of the Court of Appeals for the Fifth Circuit in *Schuessler et al. v. Commisisoner*, (March 4, 1956), which has not yet been printed in the official reports. The opinion of the Tenth Circuit is printed in Appendix D, *infra* pp. 36a-43a, and the opinion of the Fifth Circuit in the *Schuessler* case is printed in Appendix D, *infra*, pp. 44a-48a.

In the *Beacon Publishing Company* case, the single question presented was whether prepaid newspaper subscriptions should be included in the taxpayer's income for the year in which they were received, or be spread over the subscription period. The publishing company kept its books and filed its income tax returns on the accrual basis of accounting and prepaid subscriptions were credited to a liability account entitled "Prepaid Subscriptions" and included in income only as the subscriptions were earned. It was conceded that the taxpayer received the prepaid subscriptions without restrictions as to their use.

The Commissioner claimed the prepaid subscriptions were income for the year in which received, just as he contends in petitioner's case that prepaid membership dues were income when received. The Tax Court, in sustaining

the Commissioner in *Beacon Publishing Company* (1954) 21 T. C. 610, cited its decision in petitioner's case (*Automobile Club of Michigan*, 20 T. C. 1033) as a precedent for taxing prepaid income for the year when received.

The Tenth Circuit Court of Appeals reversed and held that prepaid income received by an accrual basis taxpayer constitutes income only as the expenses of earning that income are incurred. The Tenth Circuit Court of Appeals pointed out that the "claim of right" doctrine, relied upon by the Commissioner and the Tax Court, as enunciated by this Court in such cases as *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *United States v. Lewis*, 340 U. S. 590, and *Healy v. Commissioner*, 345 U. S. 278, has no application to such a case of prepaid income. The "claim of right" cases previously presented to this Court have not involved a case like *Beacon Publishing Company*, or like petitioner's case, where prepaid income is received in one year, without any dispute as to the ownership of the funds, and the expenses of earning that income are incurred in a subsequent year.

In its brief to the Court below, petitioner vigorously, but unsuccessfully, urged the Court to follow the decision of the Tenth Circuit Court of Appeals in the *Beacon* case as to the tax treatment of prepaid income.

After the decision in petitioner's case was rendered by the Court below, the Fifth Circuit Court of Appeals decided the case of *Schuessler et al. v. Commissioner* (printed in Appendix D, *infra*, pp. 44a-48a). This decision adopts and follows the decision of the Tenth Circuit Court of Appeals in the *Beacon* case and is likewise in direct conflict with the decision below in petitioner's case.

In the *Schuessler* case the taxpayer sold gas furnaces with a guarantee that he would turn the furnaces on and

off each year for five years. He kept his books on the accrual method and as furnaces were sold he set up a reserve, which he deducted on his income tax returns, to cover the cost of the service over the five-year period. The Tax Court (*E. W. Schuessler*, 24 T. C. ..., No. 28) disallowed the deduction and stated:

"This is essentially the same problem as the reporting of prepaid income in the year in which received for services to be performed in following years. The petitioner in fact, on brief, recognizes that the two problems are identical and cites *Beacon Publishing Company v. Commissioner*, 218 Fed. (2d) 697 (C. A. 10, 1955), in support of his argument that the reserve here in issue was a proper deduction in computing his income for 1946."

The Tax Court simply declined to follow the decision of the Tenth Circuit Court of Appeals in the *Beacon* case. The Fifth Circuit, in reversing the Tax Court, stated:

"We prefer the reasoning as well as the conclusion reached by the Court [in the *Beacon* case] in the Tenth Circuit. There the opinion correctly, we think, disposed of the 'claim of right' theory advanced by the Commissioner and adopted by the Tax Court in this type of case."

In its opinion, the Fifth Circuit Court of Appeals also relied on the decision of the Ninth Circuit Court of Appeals in *Pacific Grape Products Co. v. Commissioner* (1955) 219 Fed. (2d) 862. In that case the taxpayer, engaged in the fruit canning business, kept its books on the accrual basis and reported income from sales in the year it billed its buyers and took as a deduction the estimated cost of labeling and preparing the goods for shipment and brokerage fees to be paid the following years. The Tax Court dis-

allowed the deduction for the estimated expenses, but the Court of Appeals reversed, saying:

"Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not reflect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

The decisions in the *Beacon*, *Schuessler*, and *Pacific Grape Products* cases apply and follow the provisions of sections 41 and 42 of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 1a) which provide that net income shall be computed in accordance with the method of accounting regularly employed by the taxpayer in keeping his books so long as that method clearly reflects income. The decision of the Court below in petitioner's case simply ignores the statutory provisions.

It is beyond dispute that petitioner's method of reporting its income from prepaid membership dues would have been sustained if its case had been decided by the Court of Appeals for either the Fifth, Ninth, or Tenth Circuits. A situation therefore has resulted whereby taxpayers in the Fifth, Ninth and Tenth Circuits must be treated differently by the Commissioner than taxpayers in the Sixth Circuit with similar problems. For the Commissioner to be able to thus discriminate is obviously unfair and certainly most detrimental to the equitable and proper enforcement of the revenue laws. A decision of this Court is needed to eliminate this discrimination and insure uniformity of the tax treatment of prepaid income.

B. An important question of Federal law is presented which has not been, but should be, settled by this Court.

Sections 452 and 462 of the Internal Revenue Code of 1954 were intended to settle for 1954 and subsequent years the controversies which have arisen over the tax treatment of prepaid income and taxpayers' reserves for estimated expenses. Section 452, dealing with prepaid income, specifically reached the same result which the Tenth Circuit Court of Appeals reached in the *Beacon Publishing Company* case, *supra*. Section 462 specifically allowed a deduction for a reserve for estimated expenses of the type involved in the *Schuessler* and *Pacific Grape Products* cases, *supra*.

In 1955 sections 452 and 462 of the Internal Revenue Code of 1954 were repealed (Public Law No. 74, 84th Cong. 1st Sess.). The Ways and Means Committee, in recommending the repeal, stated: (H. Rep. No. 293, 84th Cong. 1st Sess., p. 4):

"Your committee in repealing sections 452 and 462 does not intend to disturb prior law as it affected permissible accrual accounting provisions for tax purposes, including the treatment of prepaid newspaper subscriptions."

The Secretary of the Treasury advised the Chairman of the Committee on Ways and Means as follows (H. Rep. 293, *supra*, p. 295):

"Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 Code. In other words,

the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner*, (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

It can also be noted that the Fifth Circuit Court of Appeals in its opinion in the *Schuessler* case, *supra*, stated that the enactment and the subsequent repeal of sections 452 and 462 of the Internal Revenue Code of 1954 were without significance in construing the provisions of the Internal Revenue Code of 1939.

The repeal of sections 452 and 462 merely aggravates the need for an early decision by this Court on the proper tax treatment of prepaid income. The Senate Finance Committee, in its report on Public Law No. 72 (Senate Report 372, 84th Cong. 1st Sess., p. 6) called attention to the confusion and uncertainty which exists as a result of lower court decisions dealing with estimated expenses and prepaid income. On page 5 of the Report, the Committee stated:

"Uncertainty will also exist in other areas with the repeal of these two provisions. In *Pacific Grape Products* (C. C. A. 9th, February 10, 1955), for example, the circuit court held that certain freight and shipping expenses incurred after the end of the year could be accrued for tax purposes as of the end of the year. An extension of the principles laid down in this case might well lead the courts in the future to permit the accrual of most estimated expenses which would be covered by section 462 even though this section is repealed."

This statement of the Senate Finance Committee indicates it would welcome—if it has not invited—a decision by this Court settling the law on the tax treatment of prepaid

income and reserves for estimated expenses, a recurring and important income tax question on which the lower courts have been unable to reach agreement.

II. The second question—whether the Commissioner in 1945 had the power to revoke, with retroactive effect, the prior determinations of his predecessors that petitioner was exempt from tax—presents an important question in Federal tax law which has not been, but should be, settled by this Court.

The question presented is of recurring importance in the administration of the income tax laws. Since our income tax system rests to a great and unique extent on voluntary compliance by the taxpayer in the self-assessment of the tax, it is exceedingly important that the taxpayer understands that he will be dealt with fairly by the Government. If the taxpayer knows that the Government can and will violate basic rules of fairness in administering the tax law, the continued success of the income tax system of voluntary self-assessment is placed in jeopardy. Certainly if the Courts inform the taxpayer that the Government need not turn square corners in dealing with him, it may be too much to expect the taxpayer to turn square corners when he deals with the Government.

There can be no doubt that the practice of the Commissioner in issuing rulings to taxpayers serves a very useful function in the proper administration of the tax laws—if taxpayers can rely on those rulings. See the article, "Taxpayers' Rulings" in *5 Tax Law Review* 105 (1950) by Mr. J. P. Wenchel, former Chief Counsel of the Bureau of Internal Revenue. The ruling process has become an important part in the administration of the tax laws. In the Annual Report of the Commissioner of Internal Revenue for the Fiscal Year ended June 30, 1955, (House Document

No. 246, 84th Cong. 2d Sess.) it is stated (page 42) that 51,060 tax rulings were issued to taxpayers in the fiscal year 1954 and 38,547 rulings were issued in the fiscal year 1955. But the success of the ruling process must be solidly based on the right of taxpayers to rely with impunity on rulings issued by the Commissioner, where the taxpayer has not been guilty of misrepresentation or fraud in the presentation of his case to the Commissioner.

There are very clear indications that the Internal Revenue Service is disturbed and concerned by the action taken in this case in the retroactive revocation of petitioner's tax exempt rulings. Shortly after the Tax Court decision was rendered, the Commissioner publicly announced in substance that he would not make a practice of doing to other taxpayers what he did to the Automobile Club of Michigan. In Revenue Ruling 54-164, 1954-1, C. B. 88, 91, the Commissioner stated:

" . . . It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment."

It is fair to infer that this ruling was a direct result of adverse criticism received by the Commissioner following the Tax Court's decision in this case. For example, in an article published in the March 1954 issue of the Journal of Accountancy (page 321), the author, a tax practitioner, expressed concern over the action taken by the Commissioner in the retroactive revocation of petitioner's tax exempt rulings, and stated:

" . . . For years the Service has followed a strict policy of respecting its rulings, and Service

officials are well aware that nothing would more disturb the course of wise administration than the retroactive reversal of rulings after taxpayers have acted in reliance upon them."

It is not enough for the Internal Revenue Service to announce that it has a general policy of not revoking rulings of tax exempt status with retroactive effect. This Court should decide the overriding question as to whether or not the Commissioner of Internal Revenue has the power to revoke prior rulings with retroactive effect if he chooses to do so.

This question has a special importance in the case of rulings as to tax exempt status. Without question the great bulk of rulings issued by the Commissioner arise on the basis of unsolicited requests by the taxpayer for a ruling. But the regulations of the Commissioner require a taxpayer claiming a tax exempt status to file an application for a ruling. Article 101-1 of Regulations 94, in force during 1938 when Petitioner received his second ruling as to tax exempt status, provided:

"A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement,

showing the assets, liabilities, receipts, and disbursements of the organization. . . .

"The Collector, upon receipt of the affidavit and other papers, will forward them to the *Commissioner for decision as to whether the organization is exempt.*

"When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created." (Emphasis supplied.)

These regulations have remained substantially unchanged since 1938, although they were amended to require certain organizations to file annual information returns under section 54(f), added in 1943 to the Internal Revenue Code of 1939.

In making a ruling under these regulations as to the tax exempt status of an organization, the Commissioner is doing much more than advising the taxpayer as to the Commissioner's interpretation of a statutory provision. The Commissioner, in appraising and passing judgment upon the purposes and activities of the organization claiming exemption from tax, acts as an administrative tribunal and performs a function judicial in nature. A ruling letter stating that the organization is exempt from taxation is treated by the taxpayer as an adjudication, and not a mere opinion of the Commissioner.

Nevertheless, the Commissioner contends that he has the power to revoke retroactively any ruling of tax exempt status made under the provisions of the above regulation, and he cites section 3791(b) of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 3a) as an acknowledgment

by Congress of such power. This Court, however, held in *Helvering v. R. J. Reynolds Tobacco Co.*, (1939) 306 U. S. 110, that section 3791(b) is without significance in cases where the Commissioner does not have power to make a retroactive ruling. In the *Reynolds* case, this Court held invalid an attempt by the Commissioner to amend retroactively the regulations concerning the tax treatment of gains realized by a corporation on its sale of treasury stock.

The dissenting opinion of Circuit Judge McAllister (Appendix B, *infra*, pp. 15a-34a) carefully reviews the facts in petitioner's case and properly stresses the gross inequity of the retroactive revocation of petitioner's tax exempt status. After reviewing the applicable precedents, and stating that the principle applied by this Court in the *R. J. Reynolds* case, *supra*, is applicable, Judge McAllister concluded:

"The Commissioner's retroactive revocation of Petitioner's tax exempt status is, in my opinion, invalid."

His opinion presents the strongest argument which petitioner can make in support of its contention that this Court should decide whether, in circumstances of the kind presented in petitioner's case, the Commissioner has the right to revoke with retroactive effect former rulings granted by his predecessor.

III. On the third question—the statute of limitations—the decision below is in apparent conflict with the decisions of two other Circuit Courts of Appeal, and the issue presents an important question of Federal tax law, which has not been, but should be, settled by this Court.

Under section 275(a) of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 2a) the three-year statute of limitations for assessment of income tax deficiencies commences to run from the date the return is filed. However,

two Circuit Courts of Appeals have held that where the Commissioner is to blame for the failure of the taxpayer to file a return when due, the three-year statute of limitations starts running from the *due date* for the return. *Balkan Nat. Ins. Co. v. Commissioner of Internal Revenue*, (C. C. A. 2, 1939) 101 F. (2d) 75, and *Stockstrom v. Commissioner of Internal Revenue*, (C. A. D. C., 1950) 190 F. (2) 283.

In the *Balkan Nat. Ins. Co.* case the Commissioner mailed a notice of deficiency in 1934 with respect to the income and profits tax liabilities for the year 1918. The taxpayer, a foreign corporation, had not filed a return for the year 1918, and the Commissioner relied upon the provision of the statute which stated that the amount of the tax may be assessed at any time in case of a failure to file a return. The taxpayer had not filed a return for 1918 for the reason that in January of 1919 all of the taxpayer's assets, including its books of account and records, were seized by the Alien Property Custodian. The taxpayer claimed that the statute of limitations commenced to run on the due date for the filing of its return for the year 1918, contending it was excused from filing a return by reason of the seizure by the Alien Property Custodian of its books and records. The Circuit Court of Appeals for the Second Circuit held that the statute of limitations started to run on March 15, 1919, under the circumstances of the case, for the following reasons (at page 78):

"While literally there has been 'a failure to file a return,' that phrase as used in section 278(a) cannot reasonably be interpreted to include a failure caused by the Government itself through seizure of the taxpayer's records. The obvious purpose of this section was to give the revenue officials unlimited time to assess and collect taxes in cases where the necessary data for determining the

amount of the tax was lacking *because of the taxpayer's fault in failing to supply it in the form of a return.* * * * In *Stearns Co. v. United States*, 291 U. S. 54, 62, 54 S. Ct. 325, 78 L. Ed. 647, the Supreme Court approved the principle that 'A suit may not be built on an omission induced by him who sues.' There the principle was applied to prevent a taxpayer from relying on the statute of limitations. We believe it is equally applicable to prevent the United States from avoiding the statute."

In the case of *Stockstrom v. Commissioner of Internal Revenue*, *supra*, the taxpayer had made gifts in trust during the calendar year 1938, and, after consulting with the head of the Federal Estate and Gift Tax Section of the Office of the Bureau of Internal Revenue in St. Louis, did not file a gift tax return for that year for the reason that the Bureau officials advised him that no tax or return was due. Stockstrom had not been correctly advised by the Bureau officials as to the law—he had, in fact, made taxable gifts in 1938. In 1948 the Commissioner issued a 90-day letter with respect to the gift tax liability for the calendar year 1938, claiming that the statute of limitations had not run since no return had been filed. The United States Court of Appeals for the District of Columbia Circuit held that the statute of limitations commenced to run on the due date for the return for the year 1938, notwithstanding that the statute provided that upon a failure to file a return the tax may be assessed at any time. In this case the Court cited the decision of the Second Circuit in *Balkan Nat. Ins. Co.*, *supra*, and said (at pages 288, 289):

"Stockstrom did not physically file a return for 1938, as we have seen. The question is, however, did he fail to file a return within the meaning of the limiting statute? Or, to put it another way,

may the Commissioner in the circumstances of this case rely upon the failure to physically file a return as destroying the period of limitation? * * *

*It has already been made to appear that Stockstrom's failure to file a return for 1938 was due to the Commissioner's ruling, made in 1938 and reaffirmed as late as 1941, that none was required of him. The Commissioner therefore induced the omission which he now relies upon as giving him unlimited time within which to assess a tax. * * **

We conclude that Stockstrom's failure to file a return for 1938 was not the sort of failure contemplated by §1016 of the Internal Revenue Code. * * *

It has been well said that the government should always be a gentlemen. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure." (Emphasis supplied.)

Petitioner find itself in the same position as the taxpayer in the *Balkan Nat. Ins. Co.* case and the *Stockstrom* case. Petitioner did not file income and excess profits tax returns on the due dates for the years 1943 and 1944 for the reason that the Bureau had previously issued two rulings to the petitioner advising that it was exempt from taxation and need not file returns so long as the character and nature of its organization and operation remained unchanged. There had been no change which placed the petitioner under a duty to file returns. The failure to file returns on the due dates was induced by the Commissioner—petitioner was entirely blameless.

Of course, petitioner does not contend that the statute of limitations should run in a case where the taxpayer obtains a tax exempt ruling by misrepresenting or concealing the facts, or where the taxpayer carries on his activities

in a manner not contemplated by the ruling. In such a case, there should be no question but that the Commissioner would have the power to revoke his ruling with retroactive effect and the statute of limitations should not bar the assessment of deficiencies. This would be a case where the Commissioner could exercise his discretion under section 3791(b) as to the extent to which he wants to make the revocation retroactive.

In the circumstances of petitioner's case, it cannot be said there was a duty to file returns on March 15, 1944 and March 15, 1945, and the running of the statute of limitations under the section 275(a) of the Internal Revenue Code of 1939 should be computed from these dates. Petitioner's failure to file a return was not, as the above cases hold, a failure to file within the meaning of section 276(a) of the Internal Revenue Code.

Furthermore, petitioner filed for the years 1943 and 1944 the return on Form 990 required by section 54(f) of the Internal Revenue Code of 1939. On these returns the petitioner furnished all information as to its income and deductions requested by the Commissioner. In filing Form 990, the petitioner filed the only return it was required to file under the regulations and tax exempt rulings issued to it, and under such circumstances the filing of Forms 990 did constitute a return for the purpose of the statute of limitations under section 275(a) of the Internal Revenue Code of 1939.

On August 25, 1948, petitioner executed waivers extending the period of time for the assessment of the tax for the years 1943 and 1944, but these waivers were executed more than three years after the due date for the filing of tax returns for 1943 and 1944, and more than three years after the filing of the returns on Form 990. Under the provisions of section 276(b) (Appendix A, *infra*, p.

3a), filing a waiver after the expiration of the three year statute of limitations is without legal effect.

It is not clear from the opinion below whether the Court disagreed with the decision of the Second Circuit Court of Appeals in the *Balkan* case and with the decision of the Circuit Court of Appeals for the District of Columbia in the *Stockstrom* case, but it is clear, that the Court below did not apply those decisions. In this connection, it can be noted that the Court below in its opinion on the question of prepaid income ignored, without comment, the decision of the Tenth Circuit Court of Appeals in the *Beacon Publishing Company* case, *supra*.

In the ordinary case, a ruling which the taxpayer receives from the Commissioner does not advise him to abstain from filing income tax returns. But when the Commissioner rules that an organization is exempt from tax, the ruling will advise the organization—as petitioner was advised—that it should not file income tax returns so long as there is no change in its purposes or method of doing business.

In seeking an answer to the question of whether the Commissioner has the power to revoke retroactively a tax exempt ruling, there is a very practical relationship between that question and the question as to the statute of limitations. If the answer is that the statute of limitations cannot run when a taxpayer fails to file a return in reliance on a tax exempt ruling, such an answer presents a special reason and need for holding that the Commissioner does not have the power to revoke retroactively. On the other hand, if the rule is that the Commissioner does have the power to revoke retroactively, it becomes imperative to find some protection for the taxpayer under the statute of limitations.

Under the opinion below, the statute of limitations would not bar the assessment of deficiencies against the petitioner for any of its taxable years, dating back to 1916. Certainly there must be some bounds to the extent to which the Commissioner can entrap a taxpayer by issuing a ruling of tax exempt status on which the taxpayer relies in good faith. If the Commissioner under the law has the right to revoke a ruling of tax exempt status with retroactive effect, every-day considerations of equity and fair play call for the application against the Commissioner of the rule of the *Balkan* and *Stockstrom* cases, *supra*—that the statute of limitations commences to run on the due date for the filing of the return for the taxable year.

The proper application of the statute of limitations in such a case presents an important question which this Court has not, but should, settle.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

STATUTES

Internal Revenue Code of 1939.

“SEC. 41. GENERAL RULE.

“The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. • • •”

“SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

“(a) General Rule. —The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. • • •”

“SEC. 54. RECORDS AND SPECIAL RETURNS.

“(f) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this

chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *

“SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

“The following organizations shall be exempt from taxation under this chapter—

.

“(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;”

“SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

“Except as provided in section 276—

“(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.”

.

“(c) Omission from Gross Income.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.”

“SEC. 276 SAME—EXCEPTIONS.

“(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a

proceeding in court for the collection of such tax may be begun without assessment, at any time.

“(b) Waiver.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.”

“SEC. 3791. RULES AND REGULATIONS.

“(b) Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.”

APPENDIX B**OPINION BELOW****UNITED STATES COURT OF APPEALS FOR THE
SIXTH CIRCUIT**

Automobile Club of Michigan,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

No. 12,247.
Appeal from the
Tax Court of the
United States.

Decided February 17, 1956.

Before ALLEN, McALLISTER and STEWART, Circuit
Judges.

ALLEN, Circuit Judge. This case arises on petition to review a decision of the Tax Court of the United States sustaining a determination of deficiencies for the calendar years 1943 to 1947, inclusive, in the aggregate amount of \$447,445.44, \$161,184.43 being income taxes and \$286,261.01 being excess profits taxes. Petitioner was organized as a nonprofit corporation without capital stock or shares and has never paid dividends. The facts are not in dispute and the questions presented are questions of law. The purposes of petitioner stated in its Articles of Association are the following:

To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First," as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign boarding of public highways; and to cooperate in

any work or movement which may tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

As found by the Tax Court:

During 1943 through 1947 the petitioner devoted most of its resources and efforts to the bettering of conditions for motorists and the promotion of proper laws relating to the use of the motor car, the promotion of travel and the use of the automobile for other modes of transportation. It engaged in the promotion of safety, the solution of traffic problems and the promotion of the formation of school boy patrols. It organized the school boy patrols in Michigan. To teachers in the schools it furnished textbooks dealing with the conduct and operation of school boy patrols. As a reward it annually took some of the patrol boys to Washington, D. C. Annually it conducted seminars in the University of Michigan to promote the education of school teachers in the state in driver training courses. Petitioner's safety and traffic and engineer departments made surveys throughout the State of Michigan at the request of various cities and communities and many of its proposals as to safety measures were adopted. Petitioner supplied to its members in Michigan and those affiliated with the American Automobile Association emergency road service. The petitioner published and furnished to each of its active members a magazine containing news about travel and news about laws as they pertain to the use of automobiles. Maps and other touring information with reference to road conditions were also provided, as was assistance to the American Automobile Association in its designation or appointment of proper places for tourists to be housed and fed. The petitioner secured reservations for its members when traveling abroad and arranged for the shipping of their cars abroad. Petitioner also promoted and furnished gratis to various communities proper directional and stop signs. In its services the

petitioner attempted to do for the motorist in a collective way that which he was unable to do as an individual.

The petitioner does not engage in or conduct any social activities.

Petitioner during 1934 had supplied the Commissioner with detailed information concerning its operations, its financial assets and liabilities, and its receipts and disbursements. On June 11, 1934, the Commissioner wrote petitioner that on the basis of evidence submitted petitioner was entitled to exemption under the provisions of Section 101 (9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that, therefore, it was not required to file returns for 1933 and prior years, and that under the provisions of Section 101 (9) of the Revenue Act of 1934 it would not be required to file returns so long as there was no change in its organization, its purposes or methods of doing business.

On July 5, 1938, after submission by petitioner of the information required concerning its claim for exemption under Section 101 (9) of the Revenue Act of 1936, the Commissioner wrote petitioner advising it that "since it appeared that there had been no change in its form of organization or activities which would affect its status, the previous ruling of the Bureau holding it to be exempt from filing returns of income was affirmed under the Revenue Act of 1936."

In May, 1945, the Commissioner wrote petitioner that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations from Federal income taxation in light of the opinion of the Chief Counsel of the Bureau of Internal Revenue as set forth in G. C. M. 23688, C. B. 1943, 283. After petitioner had furnished certain further information, the Commissioner again wrote petitioner on July 16, 1945, calling attention to the fact that Section 101 (9) of the Internal Revenue Code provides for the exemption of

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

The Commissioner's communication continued as follows:

"This office holds that the term 'club' as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term 'club.'

"The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

"It is, accordingly, held that you are not a club 'organized and operated exclusively for pleasure, recreation and other nonprofitable purposes,' within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

"Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

"In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years."

In compliance with this communication petitioner filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest, on the ground that it was exempt from taxes, and filed a petition to review the

determination of the Commissioner. During the trial before the Tax Court petitioner admitted that it was taxable "for the period subsequent to July 16, 1945," but contended that the Commissioner acted arbitrarily and without authority in revoking previous rulings as to exemption, and in determining a deficiency in taxes for any period prior to July 16, 1945. In this court petitioner contends that the Commissioner in 1945 was estopped from retroactively revoking the prior determinations, made by a predecessor Commissioner, upon the ground that there had been no change in the law or in the character and operation of petitioner as a club.

The Commissioner ruled correctly in his determination of July 16, 1945, that petitioner was not exempt from tax under Section 101 (9), Internal Revenue Code. The statute plainly applies, as decided in G. M. C. 23688, not to any and all organizations in which no dividends are declared, but to "clubs," namely, to organizations in which members commingle in fellowship. Also this section of the statute applies, not to every kind of club, but to clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes. Since petitioner performs commercial services for its members it is not the kind of organization defined in the statute. The right to exemption which arises under Section 101 (9), as it is created by statute, cannot be modified by the regulations. Since petitioner did not fall within the exemption provision it was at no time exempt from taxation, but was excused from taxation by a legal error of the Commissioner. The requirement that petitioner file returns for the years 1943 and 1944 was therefore valid and proper and, since petitioner was not required to file returns for a number of preceding years, it cannot be claimed that the ruling was arbitrary and oppressive.

As to the question of estoppel, petitioner does not assert that it has altered its position to its detriment in reliance on the former rulings of the Commissioner. In default of proof to that effect estoppel does not enter into the case.

Petitioner urges that *H. S. D. Company v. Kavanagh*, 191 Fed. (2d) 831 (C. A. 6), and *Woodworth v. Kales*, 26 Fed. (2d) 178 (C. A. 6), require reversal of the Tax Court's decision. In the *H. S. D. Company* case the District Court, which had upheld the Commissioner in changing a ruling as to the exemption from taxation of contributions to two employees' trusts, was reversed by this court. We held that the Commissioner under the facts of that case was bound by the previous rulings of his predecessor determining that contributions to the employees' trusts were exempt from taxation. The court pointed out that the reasons for the successor Commissioner's action involved no new facts and no mistake of law, but only different inferences from the same facts. We there cited with approval an opinion by Judge Raymond, *Boyer City Lumber Company v. Doyle*, D. C. Mich., 47 Fed. (2d) 772, which declared that it is "an insupportable principle to say that such a determination of value may be reopened by each succeeding Commissioner, or by the same Commissioner, because a review of the same facts results in a difference or change of opinion." In *Woodworth v. Kales*, *supra*, this court held that, where income tax was assessed under a ruling approved by the then Commissioner of Internal Revenue, a succeeding Commissioner was without authority, upon a re-examination of the same evidence to revoke such assessment and reassess an additional tax. The court concluded that there was no statutory authority for the right to reopen and re-examine the question of the 1913 fair value of the stock involved and "then, upon a re-examination of the same evidence, to reach a different result, flowing not from the discovery of any fraud or mistake, clerical or otherwise, in any fundamental fact or matter of law, but resulting only from a 'more matured judgment.'" These cases do not, however, support petitioner's contention. In the *Kales* case the court declared that the Commissioner's "mistake of law will often, or usually, justify a revision of his conclusion." In the *H. S. D. Company* case we pointed out that the facts involved "no mistake of law, but only different inferences from the same facts." The Commissioner is not bound by his own or his predecessor's

prior mistakes of law. *Chattanooga Automobile Club v. Commissioner of Internal Revenue*, 182 Fed. (2d) 551 (C. A. 6); *Austin Company v. Commissioner of Internal Revenue*, 35 Fed. (2d) 910 (C. A. 6); *Keystone Automobile Club v. Commissioner of Internal Revenue*, 181 Fed. (2d) 402 (C. A. 3); *Smyth v. California State Automobile Association*, 175 Fed. (2d) 752 (C. A. 9), (certiorari denied 338 U. S. 905. Cf. *Langstaff v. Lucas*, 9 Fed. (2d) 691, affirmed per curiam 13 Fed. (2d) 1022 (C. A. 6), certiorari denied 273 U. S. 721.

That the ruling of July 16, 1945, corrected a mistake of law cannot be disputed. The principal question was the legal significance of the word "club" in Section 101 (9) of the Internal Revenue Code. Another legal question was, if petitioner was a club in which its members commingled in fellowship, whether the organization and operation were exclusively for pleasure, recreation, and other nonprofitable purposes. The earlier Commissioners by their erroneous construction of the statute had made mistakes of law which were subject to correction by the later Commissioner.

Petitioner also claims that, irrespective of the decisions in the *H. S. D. Company* and the *Kales* cases, *supra*, it is entitled to exempt status under the doctrine of *Helvering v. R. J. Reynolds Tobacco Company*, 306 U. S. 110. This is on the theory that the Treasury Regulations 111, Section 29.101-1, and previous corresponding Regulations provided in substance that when an organization has established its right to exemption it need not thereafter make a return of income or any further showing with respect to its status unless it changes the character of its operations or the purpose for which it was originally created. An amendment made to the Regulations later in 1944 contained substantially the same provision. Congress enacted a number of Internal Revenue statutes during this period to which the Treasury Regulations cited apply, but Congress did not alter or change the law so as to affect these Regulations. Petitioner therefore claims that the Regulations cited, under the authority of the *Reynolds* case, *supra*, constituted a rule of law which can-

not be changed by a subsequent determination of the Commissioner.

In the *Reynolds* case the Supreme Court ruled that the gain secured by a corporation in the sale of its own stock in 1929 should be governed by the regulation in force in 1929, rather than by an amendment adopted by the Treasury in 1934, which made sales by a corporation of shares of its own capital stock subject to tax under certain circumstances. The Supreme Court refused to permit retroactive application of the Treasury amendments of 1934.

The Tax Court differentiated the *Reynolds* case from the instant one upon the ground that the Regulations there involved provided that a corporation realizes no gain or loss from the sale of its own stock and hence were legislative in character, while the Regulations here involved, Section 29.101-1 of Regulation 111, were administrative only.

In addition to this valid distinction between the *Reynolds* case and that presented herein we think a cogent answer to petitioner's contention is that upon this branch of the case it proceeds from its false premise that it established the right to exemption in 1934-1936, long before July 16, 1945, when the Commissioner revoked his previous ruling. Petitioner never had that right. If it had actually established such a right, the Commissioner could not rightfully revoke it, yet petitioner does not contest the Commissioner's right of revocation. The fact that the Commissioner in his earlier rulings misinterpreted the statutory meaning of the term "club" and ignored the circumstance that the services rendered petitioner's members were purely commercial, does not demonstrate that petitioner established a right to exemption. It demonstrates that the Commissioner made a mistake of law which under the weight of authority he was entitled to correct. *Chattanooga Automobile Club v. Commissioner of Internal Revenue, supra*; *Keystone Automobile Club v. Commissioner of Internal Revenue, supra*; *Smyth v. California State Automobile Association, supra*.

The retroactive ruling of the Commissioner ordering that tax returns be filed for 1943 and 1944 was authorized

under Section 3791(b) of the 1939 Code. This section reads as follows:

Retroactivity of regulations or rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

This provision clearly vests the Secretary or the Commissioner acting with approval of the Secretary, with the discretionary power to prescribe the extent, "if any," to which the ruling of the Commissioner shall or shall not be retroactive. The phrase "if any," authorizes the Secretary or the Commissioner acting with the approval of the Secretary to withhold retroactivity for the entire period involved or for any part thereof. In the instant case, if the Commissioner's ruling of July 16, 1945, were given full retroactive effect, it would require return of income taxes between the years 1934 and 1945. The Committee Reports of the House of Representatives, in recommending enactment of the predecessor section of the 1934 Act, pointed out that "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application. . . ." (House Report No. 704, 73rd Congress, 2d Session, page 38). The report then goes on to state that the cases involving rulings with reference to past transactions which have been closed by taxpayers in reliance upon existing practice, in some cases will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. This legislative history supports the above construction of Section 3791 (b).

Under the established principle that the greater power includes the less, this statute conferred authority upon the Treasury officials named to make the ruling of July 16, 1945, retroactive for only part of the period involved

and for only two of the thirteen years. We conclude that this action was in no way arbitrary. The taxpayer was not misled nor has it shown that any unusual hardship resulted from the Commissioner's action.

Petitioner next urges that the statute of limitations bars assessment of the deficiencies asserted, contending that the period of limitations commenced to run from March 15, 1944, and March 15, 1945, when the 1943 and 1944 returns were due. If this is true, the assessment is barred. Ordinarily the three-year statute of limitations begins to run from the date that the return is filed, which date was October 22, 1945. If this date controls, the assessment is not barred. Section 275 (a) I. R. C. Petitioner claims that it was under no duty to file a return and that in such case the three-year statute of limitations starts running from the date the return should have been filed if there had been a duty to file it. *Balkan National Insurance Company v. Commissioner of Internal Revenue*, 101 Fed. (2d) 75 (C. A. 2).

In this connection the chronology of the proceedings is important. The rulings of exemption were revoked on July 16, 1945. Petitioner was ordered to file 1943 and 1944 returns and these returns were filed October 22, 1945. The parties on August 25, 1948, executed consents that the income and excess profits taxes could be assessed on or before June 30, 1949, and on May 23, 1949, executed similar consents that the income and excess profits taxes could be assessed on or before June 30, 1950. The notice of deficiency was mailed to petitioner February 20, 1950.

Petitioner's assertion that his returns were due in March, 1944, and March, 1945, ignores the fact that Section 276 (a) provides that in the case "of a failure to file a return the tax may be assessed . . . at any time."

The Commissioner relies upon this statute and points out that petitioner failed to file the returns for 1943 and 1944 until three months after July 16, 1945. Petitioner answers that it was entirely blameless in its failure to file upon the due dates because its inaction was caused by the

Commissioner. But when on July 16, 1945, the Commissioner expressly required petitioner to file returns, petitioner was under an obligation to file them as ordered. The delay in filing for more than three months was not induced by the Commissioner. Moreover, petitioner voluntarily agreed twice to extension of time for the assessment of the tax. This was not induced by the Commissioner.

The returns made upon Form 990 did not constitute the returns contemplated by Section 275 (a), namely, return of income taxes. They were not appropriate for the computation or assessment of income or excess profits taxes. As held by the Tax Court, they did not contain the data necessary to enable the Commissioner to compute petitioner's liability. Two taxes were involved here, income and excess profits taxes for 1943 and 1944. The returns on Form 990 for each year were not the returns required of corporations under Section 52 (a) of the Internal Revenue Code. The contention that where two returns are required one return answers the purpose was dismissed by the Supreme Court of the United States as having no merit in *Commissioner of Internal Revenue v. Lane-Wells Co.*, 321 U. S. 219. We conclude that under this record the assessment was not barred by Section 275 (a).

The determination that membership dues received by petitioner should be included in the return of income for the year in which they were received was clearly correct, *E. H. Sheldon & Company v. Commissioner of Internal Revenue*, 214 Fed. (2d) 655, 656 (C. A. 6); *S. Loewenstein & Son v. Commissioner of Internal Revenue*, 222 Fed. (2d) 919 (C. A. 6); *Spencer White & Prentiss, Inc. v. Commissioner of Internal Revenue*, 144 Fed. (2d) 45 (C. A. 2); certiorari denied 323 U. S. 780; *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 424; *Security Flour Mills Company v. Commissioner of Internal Revenue*, 321 U. S. 281; *United States v. Lewis*, 340 U. S. 590. In this case the Supreme Court stated "The 'claim of right' interpretation of the tax laws has long been used

to give finality to that [the accounting] period, and is now deeply rooted in the federal tax system. . . . We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer."

In conclusion the Tax Court correctly decided the issue as to depreciation deductions. Petitioner relies upon two General Counsel Memoranda, Nos. 10857 and 27491, as requiring that a different formula for depreciation deduction be applied from that used by the Commissioner. These memoranda have no bearing here. They come into force only where a petitioner is shown at some time during its existence to have been an organization exempt from taxation. As previously shown, petitioner was at no time exempt.

The decision of the Tax Court is affirmed.

MCALLISTER, Circuit Judge, dissenting. While cheerfully acknowledging the persuasiveness of the excellent opinion of Judge Allen, it appears to me that the decision of the Tax Court should be reversed for the reason that I consider the Commissioner's revocation of petitioner's tax-exempt status, with retroactive effect, to be inequitable. A summary of the facts may clarify the conclusion that I think should follow.

The record discloses that in May, 1934, the Commissioner of Internal Revenue, in reply to petitioner's written claim to exemption from federal income tax, requested evidence in support of its claim. This evidence was submitted in writing by petitioner and consisted of a detailed explanation of its activities, the sources from which its income was derived, the disposition it made of its income, and facts with respect to its capital stock, dividends, and all other relevant facts relating to its activities. It disclosed that its income came from dues paid by the members of the club and the sale of advertising in a monthly magazine published by it; that no dividends or interest were paid on capital stock, and that, in fact, the club had no capital stock. The evidence submitted to the Commis-

sioner further disclosed that the club charged no entrance or initiation fees and that its activities were composed of touring service, including logs, road maps, general touring information to members, and emergency road service, such as starting of members' disabled cars on the road, towing them to official club garages, changing tires, and such similar services. Moreover, the club disclosed that it was interested in safety activities and that several men were employed by the club for work in the public schools as well as work in cooperation with the various cities of the State of Michigan to promote safety and improve traffic conditions. In addition, the club cooperated in all work or improvement which might tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

After considering this evidence, the Commissioner wrote the club on June 11, 1934, stating:

“Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation. . . . It is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business.”

More than three years later, on September 29, 1937, the Commissioner sent the club a questionnaire and requested it to supply certain information concerning its claim for exemption under Section 101(9) of the Revenue Act of 1936. The club filled in the questionnaire, signed it, and returned it to the Commissioner, with a letter dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936. Thereafter, the Commissioner again determined that the club was tax-exempt

under the Revenue Act of 1936, as it had been under the Revenue Act of 1932 and all prior revenue acts, and so notified the club by a letter dated July 5, 1938, in which the Commissioner stated:

"Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.

"Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936."

Seven years later, on May 12, 1945, a new Commissioner wrote the club, stating:

"Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103 (9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

"The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto. * * *

The Commissioner's letter further requested the club to submit evidence similar to that which it had already submitted on several occasions.

The club, in reply to the request of the Commissioner, thereafter submitted the information requested, which was, in all important particulars, the same as that which it had repeatedly furnished during the prior eleven years.

Upon receipt of this information, the new Commissioner made a determination based upon the same facts, law, and regulations as were in effect during the prior determinations, to the effect that the tax-exempt determinations of the prior Commissioner were erroneous and, accordingly, retroactively revoked the club's tax-exempt status by letter of July 16, 1945, which stated:

“Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed [by the Chief Counsel of the Bureau of Internal Revenue].

“Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938 under the provisions of the Revenue Act of 1936.

“The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.”

The above evidence which the Commissioner referred to as “the information recently submitted by you” was exactly the same evidence that had been submitted by the club eleven years before.

The above letter from the Commissioner continued:

“Section 101(9) of the Internal Revenue Code provides for the exemption of:

‘Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.’

“Prior revenue acts carry similar provisions.

“This office holds that the term ‘club’ as used in the above section of the law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term ‘club’.

“The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

“It is, accordingly, held that you are not a club ‘organized and operated exclusively for pleasure, recreation and other nonprofitable purposes’, within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

“Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

“In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to Janu-

ary 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years."

This ruling dated July 16, 1945, therefore, retroactively revoked the Club's tax-exempt status for the two prior years of 1943 and 1944.

The Commissioner's retroactive revocation of petitioner's tax-exempt status is, in my opinion, invalid.

In *Rock Island, A. & I. Railroad Co. v. United States*, 254 U. S. 141, 143, Mr. Justice Holmes made the often quoted statement that "Men must turn square corners when they deal with the Government"; but, subsequently, referring to this observation, Judge McDermott, of the Tenth Circuit, in *Howbert v. Penrose*, 38 F. 2d 577, 581, added that "the government ought to turn square corners when dealing with its citizens." That policy has, apparently, heretofore been followed by the Commissioner of Internal Revenue. Thus, in an article, "Taxpayer's Rulings" in 5 *Tax Law Review*, page 115 (1950), Mr. J. P. Wenchel, formerly Chief Counsel of the Bureau of Internal Revenue, stated that, with exceptions not here relevant, "the policy of not disturbing a ruling once it has been issued, is now strongly ingrained in the administrative practice of the Bureau. Rulings are not issued indiscriminately, hypothetically, or for a useless purpose, and once issued they can be acted upon with reliance. This policy of fair play, which has been the unvarying policy of the Bureau for a decade and more is so strong that even where a Supreme Court decision changes the Bureau's previous interpretation of the law, and such change operates to the benefit of the Government, the Bureau at times has not applied such changes retroactively to the detriment of taxpayers, including those who did not ask for a ruling. Much water has gone over the dam since the *Couzens* case [*James Couzens*, 11 B. T. A. 1040 (1928)]. Taxpayers may find it more difficult to procure Bureau rulings than in those days, but once obtained, they can rely upon the Bureau's sense of fairness, and proceed to carry out their transactions knowing that they will

not be traced with a later assessment contrary to what had been expected.”¹

The foregoing policy would seem to have been confirmed by a Revenue Ruling,² issued by the Commissioner, strangely enough, after his revocation of petitioner's tax-exempt status, and after the decision of the Tax Court in this case, in the following language: “It is the general policy of the Internal Revenue Service to limit the revocation of a ruling, with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment.” This professed policy of the Commissioner of Internal Revenue of not revoking his ruling once it had been acted upon, is consonant with the view of this court, not merely as to proper policy to be pursued, but as to the governing law, which has, for many years, been repeatedly and consistently followed in the decision of cases coming before it.

In *Woodworth v. Kales*, 26 F. 2d 178 (C. C. A. 6), in an opinion written for the court by Judge Denison, it was held that a new Commissioner is without authority to revoke the determination of a former Commissioner and reassess an additional tax based upon what appears to him to be a better judgment of the matter, if there are no newly discovered facts, no fraud or mistake, clerical or otherwise, in any fundamental fact or matter of law. See also *Routzahn v. Brown*, 95 F. 2d 766, 771 (C. C. A. 6), and *H. S. D. Co. v. Kavanagh*, 191 F. 2d 831 (C. A. 6).

¹ In the above article, the author defined the term “taxpayer's ruling,” as used therein, “to denote a statement in writing, normally in letter form, by the Commissioner of Internal Revenue or a Deputy Commissioner, setting forth the position of the Bureau with respect to a specific tax problem or problems of a specific taxpayer or taxpayers. Revenue agents and other representatives of the Bureau often give oral advice to taxpayers, but taxpayers cannot rely with impunity upon such representations or statements.”

² Revenue Ruling 54-164, 1954-1 C. B. 88, 91 (originally issued as I. R. Mimeograph No. 54-73, dated April 28, 1954.)

In *Boyne City Lumber Co. v. Doyle*, 47 F. 2d 772 (D. C. Mich.), Judge Raymond stated that it was "unsupportable" to say that a determination of the value of the taxpayer's property could be reopened by each succeeding Commissioner because a view of the same facts resulted in a change of opinion, and it was held that the right to reopen such a determination depended upon the presence of a fraud, misrepresentation, or gross error. Further, in *Penrose v. Skinner*, 298 F. 335 (D. C. Col.), the court assumed that no one could contend that a succeeding Commissioner could overrule or ignore the decisions of his predecessor unless the decisions were erroneous in law or were tainted with fraud. The reasons for these views have been variously stated in different adjudications.

Courts have uniformly held that when the executive department of the government is charged with the execution of a statute, places a reasonable construction upon it, and acts upon that construction for a number of years, changes in the construction of the statute are looked upon with disfavor, when parties who have contracted with the government on the faith of the old construction may be injured thereby. *United States v. Alabama Great Southern Railroad Co.*, 142 U. S. 615; *Jacobs v. Pritchard*, 223 U. S. 200; *Whitebird v. Eagle-Picher Lead Co.*, 28 F. 2d 200 (D. C. Okla.), affirmed 40 F. 2d 479 (C. C. A. 10).

"If the language [of the statute] seemed to us doubtful (as it does not), the practically contemporaneous construction by the Treasury Department in its regulations would require us to exclude expenses incident to the organization of a corporation and the sale of its capital stock as being within the fair meaning of 'ordinary and necessary expenses incurred in carrying on the business' of such corporation." *Simmons Co. v. Commissioner of Internal Revenue*, 33 F. 2d 75, 76 (C. C. A. 1).

"Agencies do not enjoy a ruthless discretion to ignore their pasts. Like legislatures they must guard against illegal retroactivity. Like judges they are limited by res

judicata and influenced by stare decisis.” See *National Labor Relations Board v. Guy F. Atkinson Co.*, 195 F. 2d 141, 150 (C. A. 9).

In this case, it is not claimed that the retroactive revocation was based upon any newly discovered facts, fraud, or mistake, clerical or otherwise, in any fundamental fact. The one ground upon which the Commissioner contends that the retroactive ruling was proper and valid is that the former determination of the prior Commissioner was based upon a mistake of law, and that the succeeding Commissioner merely corrected this mistake.

That the prior rulings of the other Commissioners were based on a mistake of law, and, consequently, that the rulings can be revoked with retroactive effect, is the keystone of the Commissioner's argument in this case.

While the foregoing may be said to constitute the general rule it is not every ruling based upon a mistake of law that may be afterward subject to so-called correction by the Commissioner, with retroactive effect. Where the construction of a statute by a former Commissioner has not been plainly erroneous, or in conflict with express statutory provisions, a succeeding Commissioner may not revoke the former ruling with retroactive effect.

“It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with *express* statutory provision.” (Emphasis supplied.) *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349.

A construction of a statute made by the body charged with its enforcement, which has long been followed in practical execution, and has been impliedly sanctioned by the re-

¹ See article by Frank C. Newman, “Should Official Advice Be Reliable?” 53 *Columbia Law Review*, pages 374, 376.

enactment of the statute without alteration in the particulars construed, must, *when not plainly erroneous*, be treated as read into the statute. *New York, N. H. and H. R. Co. v. Interstate Commerce Commission*, 200 U. S. 361, 401.

“This presumption that the department charged with the execution of the law has properly interpreted it is strengthened in proportion to the length of time such construction has obtained without challenge by the lawmaking power, so that, where such executive construction has been long continued, a court has a right to presume that Congress is content therewith. This exhausts the full force and effect of such construction, and, while not binding upon a court, nevertheless a court will be slow to depart therefrom, unless the language of the statute itself absolutely requires it to do so.” *Mayes v. Paul Jones & Co.*, 270 F. 121, 130 (C. C. A. 6).

Where a statutory provision is ambiguous, and the executive department which must apply and enforce it declares a construction (not in itself ambiguous) for administrative purposes, and thereafter Congress reenacts the provision without substantial change, the courts will accept that construction unless it be plainly erroneous. *Walker v. United States*, 83 F. 2d 103, 107 (C. C. A. 8).

Regulations promulgated by the Treasury Department relative to income taxes have the force and effect of law, when not in conflict with *express* statutory provisions. *Crocker v. Lucas*, 37 F. 2d 275 (C. C. A. 9).

The construction given to the statute in this case by the former Commissioners cannot be said to be plainly erroneous and in conflict with the express provisions of the statute. That construction had been followed for twenty-three years by the Treasury Department.* The prior Commis-

* Automobile clubs were granted tax immunity by O. D. 643, 3 Cum. Bull. 241 (1920). That ruling was followed by G. C. M. 2867, VII-1 Cum. Bull. 115 (1928); G. C. M. 3555, VII-1 Cum. Bull. 117 (1928).

sioners had repeatedly asked for and received information from the taxpayer club and other automobile clubs with respect to every detail of their organization, activity, and characteristics; and had repeatedly held them to be tax-exempt under the provisions of the statute in question. When, finally, the last Commissioner "reconsidered," as he said, the status of automobile clubs and assessed taxes on the ground that they were not within the statutory exemption because they were not a "social club" and that they were not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, the California State Automobile Association brought an action in the district court to recover overpayments of tax, and Judge Lemmon, now a member of the Court of Appeals of the Ninth Circuit, in a persuasive and comprehensive opinion in *California State Automobile Association v. Smyth*, 77 F. Supp. 131 (1948), held that the association was a club within the meaning of the statute, and that it was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, thus sustaining the rulings of the prior Commissioners of Internal Revenue.

When the same question came before the Tax Court in *Chattanooga Automobile Club v. Commissioner*, 12 T. C. 967 (1949), although the majority of the court held that the club was not exempt from taxation, four of the judges, in two separate opinions, dissented on the ground that the organization was a club within the meaning of the statute, and that it was organized and operated for a nonprofitable purpose.

It is true that the judgment of the district court in the Smyth case, *supra* was reversed in *Smyth v. California State Automobile Association*, 175 F. 2d 752 (C. A. 9), in an able opinion written for the court by Chief Judge Denman, in which the statute was construed in the light of the doctrine of *ejusdem generis*, pursuant to which it was held that clubs "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes," in the language of the statute, meant that the "other non-profitable purposes" must be concerned with pleasure

and recreation. However, in a similar case, *Keystone Automobile Club v. Commissioner of Internal Revenue*, 181 F. 2d 402 (C. A. 3), Judge Goodrich speaking for the court, in arriving at the same conclusion as the Court of Appeals of the Ninth Circuit to the effect that the club was not exempt from tax, rested his view on different grounds and expressly declined to construe the statute according to the doctrine of *ejusdem generis*, saying: "We have been treated to a good sized dose of so-called canons of construction known as *noscitur a sociis* and *ejusdem generis* in connection with the argument. We find them just about as helpful in settling a specific case as those vials of distilled wisdom of the ages containing the phrases 'birds of a feather flock together' and 'a man is known by the company he keeps.' Throwing a vague phrase into law Latin does not make it any more useful in construing a statute." It may be noted that the opinion of the General Counsel of the Bureau of Internal Revenue, upon which the Commissioner revoked petitioner's tax-exempt status, was posited upon a construction of the statute according to the doctrine of *noscitur a sociis*.

The construction of the Act, in the opinion of Judge Goodrich, was based upon the fact that the statute set forth numerous types of organizations which were specifically exempted from taxation; and that the type represented by an automobile club was entirely different from those spoken of in the other paragraphs; that if the taxpayer automobile club's contention was right, Congress had thrown in a lot of unnecessary and confusing classifications in the other paragraphs of the section; and that it, therefore, appeared that Congress, in speaking of "clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes," was talking "about one type of organization among individuals which was, on the whole, different from the types talked about in other paragraphs of this section." Judge Goodrich, however, pointed out that no attempt had been made to give retroactive effect to the ruling of the new Commissioner's revocation of the tax-exempt status of automobile clubs.

Both Judge Denman and Judge Goodrich, in the above cases, took notice of the place occupied by the automobile in the life of the country forty years ago and the evolution that had occurred since that time, with the suggestion that passenger cars in the early years were not used for commercial purposes, and that it may well have been that car owners in those days did club together for their common interests. At some time, this changed, and, as Judge Goodrich said, the Commissioner had the right to change his mind about the relative place of automobile owners in the scheme of things. It, therefore, may well have been the case, that automobile clubs at one time were, without question, exempt from tax, and properly held so by the Commissioner. If so, it would seem inequitable that when a succeeding Commissioner arrived at the conclusion that the situation had changed, he could revoke the tax exempt status he had determined upon for such clubs, with retro-active effect.

In *Chattanooga Automobile Club v. Commissioner of Internal Revenue*, 182 F. 2d 551, 554 (C. A. 6), Judge Martin, speaking for the court in affirming the action of the Tax Court in the Chattanooga case, *supra*, set forth the grounds for holding an automobile club not exempt from taxation in the following language:

“The petitioners contend that the words ‘other non-profitable purposes’ should not be construed as the Commissioner of Internal Revenue construed them to mean non-profitable purposes *similar* to purposes of pleasure and recreation. This argument overlooks the fact that preceding subsections of section 101 of the Internal Revenue Code specifically exempt non-profit organizations operated for literary, educational, scientific, charitable, or religious purposes, chambers of commerce, business and civic leagues, and other specified eleemosynary institutions. Were the insistence of the petitioners accepted, many of these specific exemptions would be mere surplusage, inasmuch as they would fall within the sweep of the expression ‘other non-profitable purposes’ contained in subsection

9. We think the words 'other nonprofitable purposes' carry in the context a plain connotation that the purposes must be construed as coming within the same classification as pleasure and recreation. The services rendered by each club were in part to automobiles used for business purposes and, therefore, not operated 'exclusively' for pleasure, recreation, and other similar purposes."

As far as the power of the Commissioner to change the construction of a statute *with prospective effect* goes, Judge Martin, in the *Chattanooga* case, *supra*, quoted from *Helvering v. Wilshire Oil Co.*, 308 U. S. 90, 100, wherein the Supreme Court said:

"The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States v. Dakota-Montana Oil Co.* [288 U. S. 459, 466, 53 S. Ct. 120, 77 L. Ed. 893]) . . . does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers."

All of the above serves only to show clearly in what different lights the judges of the Tax Court, the district Court, and the courts of appeals viewed the statute, even when they agreed in their conclusions, and that the interpretation and construction placed upon the statute during twenty-three years by succeeding Commissioners of Internal Revenue, who studied and examined all the various provisions of the Act, repeatedly, intently, and with specific application to the club in question, was a fair interpretation, and, certainly, not plainly erroneous or contrary to the express words of the statute. As such, it cannot be revoked by a succeeding Commissioner with retroactive effect.

It is conceivable, too, that the authorities cited by the government to sustain the changed view of the successor Commissioner, might have also sustained him if he had found it proper to construe the statute in the sense now contended for by the taxpayer. For administrative agencies designated by Congress as specialists in a particular field and advised by experts are, within a wide area, in a better position than a reviewing court to determine appropriate applications of statutes which they are directed to administer. *National Labor Relations Board v. Medo Photo Supply Corp.*, 135 F. 2d 279 (C. C. A. 2). "The construction given to a statute by those charged with the duty of executing it is always entitled to the most respectful consideration, and ought not to be overruled without cogent reasons. . . . The officers concerned are usually able men, and masters of the subject. Not infrequently they are the draftsmen of the laws they are afterwards called upon to interpret." *United States v. Moore*, 95 U. S. 760, 763.

What is the principle of law to be applied in such cases as the one before us? It is the rule that the doctrine of estoppel must be applied with great caution as against the government and its officials. Some courts have, however, applied general equitable principles to prevent inequitable governmental action, as in suits for refunds, and this doctrine has been denominated "quasi estoppel" by some authorities.

As to estoppel against the government, that principle is summed up in *Ritter v. United States*, 28 F. 2d 265 (C. C. A. 3):

"It is true . . . that when the sovereign becomes an actor in a court of justice its rights must be determined upon those fixed principles of justice which govern between man and man in like situations. . . . The acts or omissions of the officers of the government, if they be authorized to bind the United States in a particular transaction, will work estoppel against the government, if the officers have acted within the scope of their authority."

In *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co. et al.*, 284 U. S. 370, it was held that where the Interstate Commerce Commission had, upon complaint and after hearing, declared what was the maximum reasonable rate to be charged by a carrier, it may not, at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission then held it should have decided in the earlier proceeding, by declaring its own prior finding as to reasonableness to be erroneous. In passing upon the case, the court said: "The Commission's error arose from a failure to recognize that when it prescribed a maximum reasonable rate for the future, it was performing a legislative function, and that when it was sitting to award reparation, it was sitting for a purpose judicial in its nature. In the second capacity, while not bound by the rule of *res judicata*, it was bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect. It could repeal the order as it affected future action, and substitute a new rule of conduct as often as occasion might require, but this was obviously the limit of its power, as of that of the legislature itself."

In *Stockstrom v. Commissioner of Internal Revenue*, 190 F. 2d 283 (C. A. D. C.), it appeared that the taxpayer did not file gift tax returns in 1938 on a transfer to a trust because, under the Commissioner's interpretation, such gifts were of present interests and entitled to a \$5,000 exemption. The omission to file was approved in 1941. However, in 1948, following a Supreme Court decision, the Commissioner decided that the transfers in 1938 were taxable, and he, therefore, assessed a deficiency. The case went off on the question of whether the statute of limitations barred the deficiency assessment. Obviously, if a return had been filed, the deficiency assessment would have been barred. The court held that the Commissioner lacked authority to make the assessment. The holding was put on the ground that one may not found a claim upon an omission which he

himself induced. In this regard, the court quoted from Mr. Justice Cardozo in *Stearns Co. v. United States*, 291 U. S. 54: "The applicable principle is fundamental and unquestioned. 'He who prevents a thing from being done may not avail himself of the non-performance which he has himself occasioned, for the law says to him, in effect: "This is your own act, and therefore you are not damnified."'. . . Sometimes the resulting disability has been characterized as an estoppel; sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. . . . A suit may not be built on an omission induced by him who sues." The court in the *Stockstrom* case, *supra*, continued: "It has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of *Stockstrom's* failure to file a return for 1938, when the Commissioner himself was responsible for that failure." See also the scholarly and comprehensive opinion of Judge Mathes in *Smale & Robinson, Inc. v. United States*, 123 Supp. 457 (D. C. Cal.).

The taxpayer did not have notice, as claimed herein by the Commissioner, during 1943 and 1944, of the pending revocation of its exemption rulings. The Commissioner contends that it had such notice as a result of the opinion expressed in the General Counsel's Memorandum No. 23688, issued in 1943. That memorandum involved the American Automobile Association, which was an organization consisting of other incorporated clubs, and having rules against membership of any individuals. The memorandum held that the term, "club," contemplated individual members and not an association composed entirely of artificial members; and then, although it had no relation to the organization in question, the memorandum went on to say that even if there were individual members, the organ-

izations would not qualify as clubs because there was not a commingling of members in fellowship. Such opinion of the General Counsel, issued in the case of a club composed of a number of corporate clubs, was not notice to petitioner herein of revocation of its tax-exempt status as of the time that the opinion was issued. As a matter of fact, in the Commissioner's letter to the club in 1945, he did not even then notify it of the revocation of its exemption from tax, and had not, at that time, decided to do so. The Commissioner's letter merely informed the taxpayer that the Bureau was reconsidering the question of exemption "in the light of the opinion of the Chief Counsel," and asked for the filing of a questionnaire—consisting of the same information the Commissioner already had in his files from this taxpayer. It is difficult to see how it could be maintained that the taxpayer had notice of the pending revocation of its tax-exempt status in 1943 as a result of the issuance of the Chief Counsel's opinion, when in 1945, the Commissioner first notified the taxpayer that he was only proceeding to take the matter under advisement and to reconsider, at that time, the tax-exempt status of the club. Petitioner had established its own tax-exempt status in accordance with Article 101-1 of Regulation 94,⁵ in force during 1938, submitting to the Commissioner the information

⁵ "Art. 101-1. PROOF OF EXEMPTION.—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. . . ." See also Section 29.101-1 of Treasury Regulation 111, promulgated under the Internal Revenue Code of 1939, as amended by T. D. 5381, 1944 Cum. Bull. 188, 189, and Section 29.101-2, as added by T. D. 5381, *supra*.

required by such regulation. Substantially the same provisions were contained in the regulations in force during 1934 when petitioner first submitted information to the Commissioner in obtaining the first ruling that it was exempt from taxation.

As to Section 3791(b) of the Internal Revenue Code, it would not seem to apply when the Commissioner does not have the power to make a retroactive ruling; and it could hardly be contended that the Commissioner, in such a case as the one before us, had the power to revoke, with retroactive effect, a tax-exempt status theretofore acquired for any period he considered proper; whether for two years or twenty years. Congress had repeatedly, over a period of a quarter of a century, reenacted Section 101(9) of the Internal Revenue Code, subsequent to the determinations of the various Commissioners that automobile clubs, and petitioner club in particular, were tax-exempt. The Treasury's power to make retroactive amendments, changing Treasury regulations or decisions, may not be exercised where Congress has, by repeated re-enactments, given its sanction to the existing regulations. *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110. See *Studies in Federal Taxation*, Randolph E. Paul, Third Series, pages 420, et seq., Harvard University Press, 1940. The same principle is here applicable, and a succeeding Commissioner may not retroactively revoke the several prior determinations of his predecessors that petitioner is tax-exempt where Congress has by repeated re-enactments of the pertinent provision of the statute, given its sanction to such prior determinations. As to the showing of hardship suffered by petitioner through retroactive revocation of its exemption from taxation, the fact that no reserves had been set up for such comparatively large tax for a two-year period, would seem to establish the prejudice that would be suffered by petitioner to its substantial injury, and if the Commissioner had the right, as he claims, to revoke retroactively petitioner's tax exemption for a possible thirteen-year period, it might well result in complete insolvency of the taxpayer.

Petitioner relied in good faith on the rulings made by the Commissioner in 1934 and 1938 holding it exempt from taxation. In keeping with the instructions received in the ruling letters, petitioner did not file income tax returns, since no change had occurred in the organization of the club, its purposes, or activities; and in reliance upon the tax-exempt rulings, it did not, during 1943 and 1944, set up any reserve or make any other provision to cover the income and excess profits taxes later asserted by the Commissioner for those years. Petitioning club was operated, during 1943 and 1944, in all respects on the premise that it was exempt from taxation. As a result of the retroactive application of his 1945 ruling, the Commissioner asserted a deficiency in income and excess profits taxes for the years 1943 and 1944 in the amount of \$384,059.97.

Under the circumstances above set forth, it seems to me that it would be most inequitable to subject petitioner to payment of the deficiency claimed in this case as a result of the retroactive revocation of its exemption from taxation—covering a period of a quarter of a century and resulting from repeated rulings of the Commissioners of Internal Revenue in that period. In my opinion, the decision of the Tax Court should be reversed.

APPENDIX C

JUDGMENT BELOW

UNITED STATES CIRCUIT COURT OF APPEALS For the Sixth Circuit

Automobile Club of Michigan,	}	No. 12,247
Petitioner,		
v. Commissioner of Internal Revenue,		
Respondent.	}	

Before Allen, McAllister and Stewart, Circuit Judges.

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

Approved for entry.

/s/ Florence E. Allen,
United States Circuit Judge.

Filed February 17, 1956.
Carl W. Reuss, Clerk.

APPENDIX D

CONFLICTING OPINIONS

**Beacon Publishing Company, a Kansas Corporation,
v. Commissioner**

(U. S. Court of Appeals, Tenth Circuit, No. 4920, Jan. 1, 1955)

On Petition to Review the Decision of the Tax Court of the United States.

Before Bratton, Murrah, Pickett, Circuit Judges.

Pickett, Circuit Judge:

The single question presented by this petition to review a decision of the tax court is whether sums received for prepaid newspaper subscriptions should have been included in the taxpayer's income for the year in which they were received, or spread over the unexpired subscription periods.

The material facts are not in dispute. The taxpayer kept its books and filed its income tax returns on the accrual basis. It published a daily newspaper in Wichita, Kansas. The present stockholders acquired their stock in 1928 under the terms of an agreement which limited the taxpayer's bills and accounts payable to \$100,000, unless consented to in writing by the seller. Prior to 1943, it maintained on its books an account entitled "Country Circulation" in which credits were carried for country agents' receipts and prepaid subscriptions. No separate account was kept for prepaid subscriptions. The prepaid subscription income included in this account was not treated as a liability and was considered as income for the year in which it was received. Beginning in 1942, the taxpayer carried on an intensive campaign to secure prepaid subscriptions for the purpose of obtaining additional working capital without violating the \$100,000 debt limitation agreement.

The prepaid subscriptions were from thirty days to five years. The money received was not segregated and was used as working capital.

In 1943, the taxpayer employed an accounting firm to prepare a statement from its books of account. Without the consent of the Commissioner, this firm made a number of adjusting entries as of the close of 1943, one of which was to defer \$95,686.92 by credit to an account entitled "Prepaid Subscriptions". For the years 1943 and 1944, the income received from the prepaid subscriptions was credited to the account as a liability, and the amount thereof deferred as subscription income. No attempt was made to allocate costs to this account or to show the cost of obtaining the prepaid subscriptions. It is conceded that the taxpayer received the prepaid payments without any restriction as to their use. In fact, they were obtained for use by the taxpayer. They were received and treated by the taxpayer as belonging to it. The Commissioner disallowed the deferment and included the full amount thereof in the income for the year in which it was received, thereby increasing the tax liability for that year. On redetermination, the Tax Court sustained the action of the Commissioner. 21 T. C. 610.

Under Section 41 of the 1939 Internal Revenue Code the net income of a taxpayer must be computed upon the basis of the taxpayer's annual accounting period in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. If this method does not clearly reflect the income, the computation shall be made by the Commissioner in accordance with such method as will clearly reflect the income. Section 42 provides that the amount of all gross income shall be included for the taxable year in which it was received unless "under methods of accounting permitted under Section 41, any such amounts are properly accounted for as of a different period." The obvious purpose of these provisions is to obtain from the taxpayer a return reflecting its true income and to treat income received and deductible disbursements consistently. *United States v. Mitchell*, 271 U. S. 9, 12.

Generally, the two methods of accounting used to determine income are the accrual and the cash receipts and disbursements methods. We are here concerned with the accrual method. Where a taxpayer keeps his books and files his returns on an accrual basis, income is accounted for in the year in which the amount is earned or becomes fixed, irrespective of when the payment is ultimately received. "It is the right to receive and not the actual receipt of income that determines when income must be included in gross income for income tax purposes. When the right to receive income becomes fixed and absolute, the duty of one on the accrual basis to report it arises." *United States v. Harmon*, 10 Cir., 205 F. 2d 919. See also *Clark v. Woodward Construction Co.*, 10 Cir. 179 F. 2d 176. It is quite clear that under the accrual method of accounting it is the accrual of income and not its actual receipt that determines when it is taxable. *H. Liebes & Co. v. Commissioner*, 9 Cir., 90 F. 2d 932. Thus, in this case, if the taxpayer had sold a large number of subscriptions to its paper for the taxable year, payments for which were to be made in a subsequent taxable year, the amount would accrue and be taxable when the subscriptions were sold. An important feature of the accrual system is that income shall be reported at such a time that it will, so far as possible, be offset by expenditures incident to earning it, rather than expenditures related to earning other income. *Commissioner v. Security Flour Mills*, 10 Cir., 135 F. 2d 165, *aff'd*, 321 U. S. 281; *Aluminum Castings Co. v. Rontzalin*, 282 U. S. 92; *Niles Bement Pond Co. v. United States*, 281 U. S. 357; *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115; *American National Company v. United States*, 274 U. S. 99; *United States v. Anderson*, 269 U. S. 422.

In sustaining the Commissioner, the Tax Court applied what has become known as the "claim of right" doctrine. The Commissioner says in his brief that the doctrine is "the legal theory underlying the Tax Court's decision." This theory, as applied to taxable income, is that when a taxpayer receives funds during a taxable year under a

claim that he has the right to possession and use of the funds with no restriction as to their disposition, it is income even though the claim subsequently is found to be invalid, and the taxpayer is required to repay the funds. *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *United States v. Lewis*, 340 U. S. 590; *Healy v. Commissioner*, 345 U. S. 278; *Commissioner v. Security Flour Mills Co.*, *supra*.¹ In each of these cases the question presented was whether the ownership or claim of ownership to the funds was sufficient for them to be taxed as income to the person receiving them, and there was no issue as to when they were returnable for taxation. In the so-called "claim of right" cases, the taxpayer's accounting system was of no importance. If taxable funds are received, under the claim of right doctrine they are returnable in the year received regardless of the method of accounting employed by the taxpayer.

In the instant case, there is no dispute as to the ownership of the funds. Admittedly, they belong to the taxpayer with no restriction as to disposition. The question

¹ In *Healy v. Commissioner*, *supra*, in referring to the "claim of right" principle the Supreme Court said:

"The phrase 'claim of right' is a term known of old to lawyers. Its typical use has been in real property law in dealing with title by adverse possession, where the rule has been that title can be acquired by adverse possession only if the occupant claims that he has a right to be in possession as owner. The use of the term in the field of income taxation is analogous. There is a claim of right when funds are received and treated by a taxpayer as belonging to him. The fact that subsequently the claim is found to be invalid by a court does not change the fact that the claim did exist. A mistaken claim is nonetheless a claim. *United States v. Lewis*, 340 U. S. 590 (1951)." (Footnotes omitted.)

In *North American Oil Consolidated v. Burnet*, *supra*, the rule was succinctly stated as follows:

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

is, when shall they be taxed? The tax court, as it has in other cases, took the literal language from the context of the opinions in the foregoing cases and applied it to the prepaid income here even though there is no dispute as to the ownership of the funds.² It gave no consideration to the fact that the taxpayer accounts for its income under the accrual method and will not incur the expenses necessary to earn the income until following taxable years. In other words, the tax court holds that advance payments received by a taxpayer, which are subject to income tax, must be returned in the year of receipt if owned or claimed by the taxpayer, regardless of the method of accounting which has been adopted, or when the funds are actually earned. Such application of the rule limits the accrual method to that class of cases where money has been earned and the right to it has been fixed, but the receipt is delayed to a subsequent taxable period. The application of the doctrine would in most cases result in a distortion of an accrual taxpayer's true income. For instance, a construction contractor might be paid in advance for the construction of a building which would require the following year to complete, with all of the costs of construction incurred during the following year. A rancher might sell his next year's calf or lamb crop, and receive payment for it in advance, with the entire cost of production to be incurred the following year. A manufacturer might be paid in advance for articles to be made and delivered in a subsequent year. In each of these cases, if the tax court's application of the rule is carried to its logical conclusion, the prepaid receipts, because the taxpayer received them under a claim of right, would be taxable during the year in which they were received, even

² South Tacoma Motor Co. v. Commissioner, 3 T. C. 411; Your Health Club, Inc. v. Commissioner, 4 P. C. 385; E. B. Elliott Co. v. Commissioner, 45 B. T. A. 82; National Airlines, Inc. v. Commissioner, 9 T. C. 159; Automobile Club of Michigan v. Commissioner, 20 T. C. 1033; and see also South Dade Farms v. Commissioner, 5 Cir., 138 F. 2d 818; Capital Warehouse Co. v. Commissioner, 8 Cir., 171 F. 2d 395; Booth Newspapers, Inc. v. Commissioner, 17 T. C. 294, affirmed, 6 Cir., 201 F. 2d 55.

though the taxpayer kept his books on an accrual basis. The right to return income on a completed contract basis would be destroyed. This would produce an incongruous result. It would permit the collection of taxes during periods not contemplated by the accrual method of accounting, and force the taxpayer into a cash receipts basis for all prepaid items. Such was not the reasoning or the purpose of the cases relied upon. Such an application of the rule requires the taxpayer to report its prepaid income on a cash basis and to accrue its deductions. It creates a hybrid bookkeeping system and results in a tax return which does not clearly reflect income. *Commissioner v. South Texas Co.*, 333 U. S. 496, 501. To a large extent, it destroys the principle inherent in the accrual method of accounting. Plainly, Section 42 contemplates that prepaid sums can be returned in a year other than when received. It says that income shall be included in the taxable year received "unless, under methods of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period." This is not a case where the Commissioner has exercised his broad discretion to require a taxpayer to adopt an accounting method which will clearly reflect income, but is one in which he has improperly applied a legal principle.

Congress has taken cognizance of the existing situation as to prepaid income and has sought to remedy it by statute. The 1954 Internal Revenue Code, with certain limitations, permits accrual basis taxpayers to defer the reporting of advanced payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned and to assure that items of income and deductions will be properly taken into account.³

³ The report of the Senate Finance Committee upon this section reads:

"Present law provides that the net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed by the taxpayer, if such method clearly reflects the in-

The Commissioner urges that since the taxpayer had for years prior to 1943 and 1944 carried these accounts on its books as cash items, it cannot change its system of accounting without the consent of the Commissioner. Treasury Regulations 111, Sec. 29.41-2. The Commissioner is vested with wide discretion in determining whether a change in a taxpayer's method of accounting shall be allowed. *Brown v. Helvering*, 291 U. S. 193; *Aluminum Castings Co. v. Routzahn*, supra; *United States v. Anderson*, supra; *United States v. American Can Co.*, 280 U. S. 412; *Niles Bement Pond Co. v. United States*, supra. The taxpayer, however, did not seek to change its accounting system. It did no more than apply the method adopted and in use to clearly reflect its income. This the taxpayer had the right to do and the Commissioner had the right to require it. *United States v. American Can Co.*, supra. A discretion of the Commissioner does not empower him to add to the taxpayer's gross income for a given year, an item which rightfully belongs in another year. *Commissioner v. Frame*, 8 Cir., 195 F. 2d 166; *Commissioner v. Mnookin's Estate*, 8 Cir., 184 F. 2d 89.

(Continued from preceding page)

come, and the regulations state that approved standard methods of accounting will ordinarily be regarded as clearly reflecting taxable income. Nevertheless, as a result of court decisions and ruling, there have developed many divergencies between the computation of income for tax purposes and income for business purposes as computed under generally accepted accounting principles. The areas of difference are confined almost entirely to questions of when certain types of revenue and expenses should be taken into account in arriving at net income.

"The changes embodied in the House bill and in your committee's bill are designated to bring the income-tax provisions of the law into harmony with generally accepted accounting principles, and to assure that all items of income and deductions are to be taken into account once, but only once in the computation of taxable income.

* * * * *

The House and your committee's bill permit accrual-basis taxpayers to defer the reporting of advance payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned." Report of the Committee on Finance of the United States Senate, p. 62, 1954 U. S. Code Congressional Service, p. 2691-2.

We have no doubt that the taxpayer could not change its method of keeping books without the consent of the Commissioner, even as to items, if the change resulted in an avoidance of the payment of taxes due, nor do we have any doubt but that a taxpayer may, without the consent of the Commissioner, apply the method of accounting which he has adopted, though not theretofore applied to a particular item, when that change will correct errors and clearly reflect his income. We think the change in this case falls within the latter category.

The decision of the tax court is reversed.

Bratton, Circuit Judge dissenting:

The taxpayer received the funds representing prepaid subscriptions under claim of right without any restrictions in respect to their use. The funds were placed in the capital structure of the taxpayer with no limitations or proscriptions upon their application, enjoyment, or disposition. The taxpayer was required to make refunds in case of cancellations of prepaid subscriptions, but that obligation was contingent. It depended entirely upon whether cancellations were made. Unless a subscription should be cancelled no refund would be made. It seems clear to me that under the settled law in force at the time, the entire amount received for prepaid subscriptions constituted income returnable for the year in which it was received, even though the taxpayer kept its books and made its returns on the accrual basis. *Brown v. Helvering*, 291 U. S. 193; *South Dade Farms v. Commissioner*, 138 F. (2d) 818; *Clay Sewer Pipe Association v. Commissioner*, 135 F. (2d) 130; *Capital Warehouse Co. v. Commissioner*, 171 F. (2d) 395. And therefore I would affirm the decision of the Tax Court.

**E. W. Schuessler and Aline Schuessler
v. Commissioner**

(U. S. Court of Appeals, Fifth Circuit, No. 15751, March 14, 1956)

Petition for Review of Decision of The Tax Court of the United States (District of Alabama).

Before Borah, Tuttle and Jones, Circuit Judges.

Tuttle, Circuit Judge:

This is a petition for review of a decision by the Tax Court disallowing a deduction in 1946 of an item of \$13,300.00, representing a reserve set up by taxpayers while keeping their books on the accrual basis, to represent their estimated cost of carrying out a guarantee, given with each of the furnaces sold by them during the year, to turn the furnace on and off each year for five years.

The opinion of the Tax Court treats the matter as though ample proof was offered by the taxpayer (hereafter the husband will be called "taxpayer") to raise the legal issue and we find the record warrants this treatment. Taxpayer was in the gas furnace business in 1946, during which he sold 665 furnaces, each with a guarantee that he would turn the furnace on and off each year for five years. The fact that such service, if performed, would cost \$2.00 per call was amply established. The taxpayer, himself a bookkeeper and accountant prior to entering this business, testified to his keeping his books on the accrual method and claimed that the only way his income could be accurately reported was by charging against the cost of furnaces sold in 1946 the reserve representing the amount which he became legally liable to expend in subsequent years in connection with the sales. The proof was clear that he actually sold the furnaces for \$20.00 to \$25.00 more than his competitors because of his guarantee, which they did not give.

We think it quite clear that petitioner's method of accounting comes much closer to giving a correct picture of

his income than would a system in which he sold equipment in one year and received an inflated price because he obligated himself, in effect, to refund part of it in services later but was required to report the total receipts as income on the high level of the sales year and take deductions on the low level of the service years. The reasonableness of taxpayer's action, however, is not the test if it runs counter to requirements of the statute.

We find that not only does it not offend any statutory requirement, but, in fact, we think it is in accord with the language and intent of the law.¹ Clearly what is sought by this statute is an accounting method that most ac-

¹ See in this connection the following sections of the Internal Revenue Code of 1939:

Sec. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *.

(26 U. S. C. A. 1952 ed., Sec. 41.)

Sec. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

The deductions and credits * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period * * *.

(26 U. S. C. A. 1952 ed., Sec. 43.)

See also Treasury Regulation 111 as follows:

Sec. 29.41-1. COMPUTATION OF NET INCOME.—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of

(Continued on next page)

curately reflects the taxpayer's income on an annual accounting basis.²

The decisions of the Tax Court and of the several Courts of Appeals are not uniform on this subject, some circuits requiring a mathematical certainty as to the exact amount of the future expenditures that cannot be satisfied in the usual case. Other circuits, seemingly more concerned with the underlying principle of charging to each year's income reasonably ascertainable future expenses necessary to earn or retain the income, have permitted the accrual of restricted items of future expenses. Two of this latter category are *Harrold v. Commissioner*³ and *Pacific Grape Products Co. v. Commissioner*.⁴

In the *Harrold* case the taxpayer was permitted to deduct from its gross income in 1945 the estimated cost of back filling a tract of land which would be done under state law requirements in the year 1946. The Court there said:

“ * * * when all the facts have occurred which determine that the taxpayer has incurred a liability in the tax year, and neither the fact nor the amount of the liability is contested, and the amount, although not definitely ascertained, is susceptible of estimate with reasonable accuracy in the tax year, deduction thereof from income may be taken by a taxpayer on

(Continued from preceding page)

expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for * * *.

² This principle was early recognized in *United States v. Anderson*, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347.

³ (4 Cir.), 192 F. 2d 1002.

⁴ (9 Cir.), 219 F. 2d 862.

an accrual basis." *Harrold v. Commissioner*, (4 Cir.), 192 F. 2d 1002, 1006.

The Pacific Grape Products case is also, it seems to us, indistinguishable in principle from the case before us. There the taxpayer accrued the sales price of canned goods sold on December 31, and at the same time deducted the estimated cost of labeling and preparing the goods for shipping and brokerage fees to be paid the following year. The Tax Court, with six judges dissenting, accepted the Commissioner's view that the deductions should be disallowed. The Court of Appeals reversed, saying:

"Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not reflect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

The case of *Beacon Publishing Co. v. Commissioner*^{*} is considered by both parties here and was noted by the Tax Court as of especial significance. That case involved the treatment of prepaid income received by the Beacon Publishing Co. covering subscriptions to be furnished in subsequent years. The Tax Court in its decision here said:

"* * * This is essentially the same problem as the reporting of prepaid income in the year in which received for services to be performed in following years. The petitioner in fact, on brief, recognizes that the two problems are identical and cites *Beacon Publishing Co. v. Commissioner*, 218 F. 2d 697 (C. A. 10, 1955), in support of his argument that the reserve here in issue was a proper deduction in computing his income in 1946."

^{*} (10 Cir.), 218 F. 2d 697.

The Tax Court then simply declined to follow the Court in the Beacon case, preferring to adhere to its own views as expressed in *Curtis A. Andrews v. Commissioner*, 23 T. C. 1026. We prefer the reasoning as well as the conclusion reached by the Court in the Tenth Circuit. There the opinion correctly, we think, disposed of the "claim of right" theory advanced by the Commissioner and adopted by the Tax Court in this type of case.⁶

Finally we think the enactment in 1954 of Section 462 of the Internal Revenue Code of 1954⁷ and its subsequent repeal constitute no legislative history bearing on the construction of the provisions of the Internal Revenue Code of 1939.⁸

The record below amply supports the contention of the taxpayer that there was a legal liability created in 1946, when the purchase price was paid for the gas furnaces, for the taxpayer to turn the furnaces on and off for the succeeding five years; that the cost of such service as reasonably established at a minimum of \$2.00 per visit; and that the payment of \$20.00 to \$25.00 extra by the purchasers fully proved their intention to call upon the taxpayer each year for the service. These facts authorized the setting up of a reserve out of the 1946 income to enable the taxpayer to meet these established charges in future years. The decision of the Tax Court is therefore in error and must be reversed.

REVERSED with directions to enter judgment for the taxpayer.

⁶ See *Beacon Publishing Co. v. C. I. R.*, 218 F. 2d 697, 699.

⁷ 26 U. S. C. A. §462.

⁸ For an interesting discussion of the history of this legislation see Sen. Rep. No. 372, 84 Cong., 1st Sess. (1955 U. S. Code Congressional and Administrative News, pp. 2314-2319). See also Sporrer, *The Past and Future of Deferring Income and Reserving for Expenses*, TAXES (Mag.) January 1956, 45.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE SIXTH CIRCUIT**

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 144-169) are reported at 20 T. C. 1033. The opinion of the Court of Appeals (R. 190-219) is reported at 230 F. 2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1956 (R. 190). The petition for a writ of certiorari filed on May 15, 1956, was granted on October 8, 1956 (R. 219). The jurisdiction of this Court rests upon 28 U. S. C., section 1254.

QUESTIONS PRESENTED

I. Membership Dues

Was the petitioner, reporting on the accrual basis, entitled to report prepaid membership dues as income when earned, rather than when received, in accordance with the method of accounting regularly employed by petitioner in keeping its books?

II. Retroactive Revocation of Tax Exempt Status

Did the Commissioner of Internal Revenue in 1945 act arbitrarily and without authority in revoking *with retroactive effect* the rulings previously made by a predecessor Commissioner which held that petitioner was exempt from taxation, when there had been no change in the law or in the character and operation of the petitioner as a club?

III. Statute of Limitations

If the retroactive revocation of petitioner's exemption was not invalid, did the statute of limitations bar the assessment of the deficiencies asserted for the years 1943 and 1944?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions and regulations involved are as follows:

With respect to Question I, section 41 and section 42(a) of the Internal Revenue Code of 1939; sec. 29.41-1 and sec. 29.41-3 of Treasury Regulations 111.

With respect to Question II, section 101 (9) and section 3791(b) of the Internal Revenue Code of 1939; Art. 101-1 of Treasury Regulations 86, Art. 101-1 of Treasury Regulations 94, and sec. 29.101-1 of Treasury Regulations 111.

With respect to Question III, section 52 (a), section 54 (f), section 275 (a), and section 276 (a) and (b) of the Internal Revenue Code of 1939.

These provisions are printed in Appendix A, *infra*, pages 1a through 11a.

STATEMENT

The facts with respect to the issues are as follows:

Preliminary

The petitioner was incorporated under the laws of the State of Michigan on July 21, 1916, as a non-profit organization (R. 16). It has never had capital stock, and none of its earnings have been, or can be, distributed to its members. In the event of dissolution, petitioner's funds must be distributed to one or more non-profit organizations devoted to one or more of the purposes of petitioner or to one or more educational or charitable organizations

to be selected by the Board of Directors (Exhibit 2 to Stipulated Facts; R. 16, 42). The functions of petitioner are carried out by its officers and employees under the direction of a Board of Directors which is elected annually. The members of the Board of Directors serve without compensation (R. 16).

Petitioner renders various services to its members. Some of the services are of a direct and immediate benefit to the member, such as emergency road service when his car is disabled, the receipt from petitioner of maps, road and other travel information, and a monthly magazine containing news of travel and of laws pertaining to the use of automobiles (R. 124-125).

Many services rendered by petitioner for the benefit of its members are of a civic nature. Petitioner engages in the promotion of safety and in the elimination of traffic problems, including the advocacy of reasonable and useful traffic laws and ordinances. Petitioner pioneered the promotion of schoolboy patrols and its plan was adopted on a national scale. The petitioner has annually conducted seminars at the University of Michigan, for the education of school teachers in the state in driver training courses. Petitioner has promoted, and furnished without charge to various communities, the proper directional and "stop" signs for roads and highways. Petitioner tries to do for the motorist in a collective way that which he is unable to do as an individual (R. 126).

I. Membership Dues

For the services rendered by petitioner, members paid annual dues which accounted for approximately 95% of petitioner's gross income (Ex. 11 to Stipulated Facts; R. 19, 68c). The dues were paid in advance for a 12 month period, and petitioner received dues in every month of the

year. A member paid his dues, not for past services rendered, but for services to be rendered to him by petitioner during the 12-month period following the payment of the dues. In the case of membership dues paid in December of any year, 11/12ths of the petitioner's services and expenses with respect to such dues were incurred in the following calendar year (R. 129, 130).

During all the years involved in this proceeding, and for many years prior thereto, petitioner recorded its income and disbursements in its books and records on a calendar-year basis and upon the accrual method of accounting. It filed all tax returns for the years involved in this proceeding in accordance with the method by which it kept its books—on the accrual method.

Under petitioner's accrual method of accounting, the dues received from a member were recorded by petitioner in its books in an account designated as "Unearned Membership Dues." Each month as the dues were earned petitioner transferred 1/12th of the amount of the dues from the "Unearned Membership Dues" account to an account designated on its books as "Membership Income". Thus, if a member paid his dues in December 1945, petitioner's books recorded only 1/12th of the dues as income for 1945, and 11/12ths of the dues were recorded as income for the year 1946. The amount carried in the "Unearned Membership Dues" account was carried on petitioner's books as a liability (R. 128).

The petitioner consistently maintained a policy of refunding on a prorata monthly basis the unearned membership dues in the case of the termination of a membership by reason of the death or resignation of the member or for any other reason. During the years 1943 to 1947, petitioner made refunds due to cancellation of memberships in the amount of \$90,691.62 (R. 142).

Petitioner adopted its method of accounting for dues on the recommendation of its accountants as the sound and proper accounting method of treating prepayments of membership dues (R. 129, 130). The purpose and function of the method was to have the income earned during an accounting period charged with the expenses attributable to that income. The method was not adopted for tax reasons. It was adopted during the period when the Commissioner had ruled that petitioner was exempt from taxation. This method of accounting for membership dues was consistently followed by the petitioner for the years ending December 31, 1934 to December 31, 1947, inclusive.

II. Retroactive Revocation of Tax Exempt Status

During the early part of 1934, the petitioner inquired of respondent whether it was exempt from payment of the capital stock tax imposed by section 215 of the National Industrial Recovery Act (R. 16, 17). By letter dated May 16, 1934 the respondent wrote to petitioner in reference to the inquiry and stated that in order to determine whether petitioner was exempt from the capital stock tax, "the Bureau must first determine whether you are entitled to exemption from Federal income taxation under the provisions of section 103 of the Revenue Act of 1932." (Ex. 3 to Stipulated Facts; R. 17, 44.)

In his letter of May 16, 1934, the respondent requested petitioner to supply in affidavit form a detailed explanation of its activities, the sources from which its income was derived, the disposition made of such income, facts relative to whether or not it paid interest or dividends on its capital stock, facts with respect to whether any of its income was credited to surplus or might inure to the bene-

fit of any private shareholder or individual, and all other relevant facts relating to its activities which might affect its status (R. 44-45).

Petitioner, by a statement sworn to by its Assistant Treasurer, submitted to the Commissioner all of the information and data requested, including a financial statement as of April, 1934 (Ex. 4 to Stipulated Facts; R. 17, 45-47). On the basis of this information, Commissioner Guy T. Helvering (by his Deputy Commissioner) made his first determination that the petitioner was exempt from taxation, and by a letter dated June 11, 1934¹ notified the petitioner of that determination, and stated further:

¹ Following is the full text of the letter of June 11, 1934, with emphasis supplied (Ex. 5 to Stipulated Facts; R. 17, 48-49).

EXHIBIT 5

June 11, 1934.

IT:E:RR
CQ

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

Sirs:

Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation.

The evidence submitted discloses that the Detroit Automobile Club was incorporated under the laws of the State of Michigan in 1916 and that the name of the organization was changed to the Automobile Club of Michigan in 1931. You were formed "to promote and foster the healthy growth of the automobile industry; to secure the adoption and endorsement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of 'Safety First' as applied to automobile traffic; to promote touring and to

(Continued on following page)

"You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101 (9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business."

(Continued from preceding page)

obtain and furnish touring information and the necessary sign boarding of public highways; and to co-operate in any work or movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general."

Your assistant treasurer in an affidavit states that your activities consist of a touring service, such as logs, road maps, general touring information to members; emergency road service such as starting of members' disabled cars on the road, towing cars to official club garages, changing tires, etc.; the publication of the Michigan Motor News, a monthly magazine published for your members only; and the employment of several men to work in public schools in cooperation with various cities of the state to promote safety and to improve traffic conditions. It is stated that you cooperate in any work or improvement which tends to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general; that your income is derived from membership dues, sale of advertising in your publication, and interest on funds; that you do not pay interest or dividends; and that you have no capital stock. Your financial statement discloses that your income is used to defray executive, legal, touring, emergency road service, safety and traffic signs, and miscellaneous operating expenses.

Based on the foregoing, it is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business.

(Continued on following page)

About three years later, on September 29, 1937, respondent sent petitioner a questionnaire calling for information as to petitioner's right to exemption under section 101(9) of the Revenue Act of 1936. Petitioner filled in the questionnaire, sworn to by its Treasurer, and returned it to the respondent with a letter of transmittal dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936 (Ex. 6 to Stipulated Facts; R. 17, 50-58). On the basis of that information, Commissioner Helvering (by his Deputy Commissioner) determined for the second time that the petitioner was ex-

(Continued from preceding page)

Any changes in your form of organization or method of operation, as shown by the evidence submitted, must be immediately reported by you to the collector of internal revenue for your district, in order that the effect of such changes upon your present exempt status may be determined.

The exemption granted in this letter does not apply to taxes levied under other titles or provisions of the respective revenue acts, except in so far as exemption is granted expressly under those provisions to organizations enumerated in section 103 of the Revenue Act of 1932.

A copy of this letter is being transmitted to the collector of internal revenue for your district.

By direction of the Commissioner.

Respectfully,

(Signed) Chas. T. Russell

Deputy Commissioner.

empt from income taxation and by a letter² dated July 5, 1938, advised the petitioner:

"Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936." (Emphasis supplied.)

² Following is the full text of the letter of July 5, 1938 (Ex. 7 to Stipulated Facts; R. 59):

EXHIBIT 7

July 5, 1938

IT:RR:MM

Automobile Club of Michigan,
139 Bagley Avenue,
E. Detroit, Michigan.

Sirs:

Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.

Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936.

By direction of the Commissioner.

Respectfully,

(Signed) John R. Kirk,
Deputy Commissioner.

MM/ij-1

In reliance upon the ruling letters of June 11, 1934 and July 5, 1938, petitioner considered itself exempt from income taxation and, in literal compliance with the ruling letters, did not file income tax returns; except that after the enactment of section 54 (f) (a new provision, added to the Internal Revenue Code of 1939 by section 117 of the Revenue Act of 1943, requiring annual returns to be filed by certain tax-exempt organizations) petitioner did file annual returns on Form 990 for the calendar year 1943 and subsequent years. In further reliance upon the rulings, petitioner kept its books and managed its affairs on the assumption that it was exempt from taxation (R. 138).

The petitioner did not hear again from the respondent as to its tax exempt status until it received a letter dated May 12, 1945 in which it was stated that the Bureau is *now reconsidering* the tax exemption of automobile associations in the light of an opinion rendered in 1943 by the Chief Counsel of the Bureau of Internal Revenue. This letter³ transmitted Treasury Form 1025, the exemption

³ Following is the full text of the letter dated May 12, 1945 (Ex. 7 to Stipulated Facts; R. 8, 59-60):

EXHIBIT A

May 12, 1945

IT:P:T-1

FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit, Michigan

Gentlemen:

Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

(Continued on following page)

affidavit for use of organizations claiming exemption from taxation under section 101 (9) of the Internal Revenue Code of 1939, and requested that the form be filed within 30 days. The letter stated that the information requested in Item 8 of the form, concerning the specific activities of the petitioner, should cover the last complete year of operation. No request was made with respect to petitioner's activities for prior years.

(Continued from preceding page)

The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto as set forth in G. C. M. 23688, C. B. 1943, 283.

It is therefore requested that you fill in all the information outlined on the enclosed Form 1025. Attention is called to the data requested in item 15: The classified statement of the receipts and expenditures referred to thereon should be submitted but it will not be necessary for you to furnish copies of your articles of incorporation and bylaws as copies thereof are on file in this office. However, if any changes have been made thereon, a copy of such amendments and the authorization therefor should be furnished.

The information requested in item 8 should cover all your actual activities during your last complete year of operation.

The above information should be furnished the Bureau within thirty days from the date of this letter, marked for the attention of IT:P-T-1-FDF.

Very truly yours,

Norman D. Cann
Deputy Commissioner
By (Signed) L. K. Sunderlin
Chief of Section

Enclosure:

Form 1025
FDFoley/em-3
5-5-45

Before the expiration of the 30-day period, petitioner completed and mailed Form 1025 to the Commissioner, giving him all the information requested. On the basis of that information, Commissioner Joseph D. Nunan (by a Deputy Commissioner) sent a letter dated July 16th, 1945 in which he ruled that the petitioner was not exempt from taxation under section 101 (9) of the Internal Revenue Code of 1939. In addition, the letter^a specifically revoked the prior rulings of June 11, 1934 and July 5, 1938 which held that the petitioner was exempt from taxation, and the letter ordered petitioner to file income tax returns retroactivity for the year 1943 and 1944.

^a Following is the full text of the letter of July 16, 1945 (Ex. B to Stipulated Facts; R. 18, 66-67), with emphasis supplied.

EXHIBIT B

July 16, 1945

IT:P:T:1

FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

Gentlemen:

Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G. C. M. 23688; C. B. 1943, 283.

Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in

(Continued on following page)

Not until the petitioner received the letter of July 16, 1945 was it advised or informed that Commissioner Nunan (or any of his deputies) had determined that petitioner was no longer exempt from taxation. Not until receipt of this letter was the petitioner advised that it could no longer rely on the ruling letters of June 11, 1934 and July 5, 1938. At no time prior to July 16, 1945 did the Commissioner advise petitioner that it must, despite the prior ruling letters, file income tax returns for 1943 and subsequent years.

(Continued from preceding page)

public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.

Section 101(9) of the Internal Revenue Code provides for the exemption of:

"Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similar provisions.

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other non-profitable purposes", within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore,

(Continued on following page)

The retroactive revocation in 1945 of the determinations made by the prior Commissioner in 1934 and 1938 with respect to petitioner's tax exemption was not based on any intervening change in the statute or in the manner in which petitioner conducted its activities, or on any misrepresentation, concealment, or fraud on the part of the petitioner. The revocation was based solely on Commissioner Nunan's opinion that the previous determinations and rulings rendered to petitioner were erroneous, since fellowship between the petitioner's members did not play a material part in the life of the organization.

Petitioner at the time of the hearings before the Tax Court, and in its Brief to the Tax Court, conceded that the Commissioner's ruling of July 16, 1945 could be applied with prospective effect so as to subject petitioner to tax for taxable years ending after the date it received the letter of July 16, 1945. But petitioner at all times has denied any validity to the attempt to revoke retroactively the specific rulings received by petitioner in 1934, and

(Continued from preceding page)

are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

By direction of the Commissioner.

Very truly yours,

(Signed) Norman D. Cann

Deputy Commissioner

again in 1938, that it was exempt from taxation and exempt from filing income tax returns so long as there was no change in its form of organization or activities.

III. Statute of Limitations

The due date for filing an income tax return for the calendar year 1943 was on March 15, 1944 and the due date for filing a return for the calendar year of 1944 was on March 15, 1945. The petitioner did not file income tax returns for the calendar years 1943 and 1944 on or before the due dates, in view of the rulings which petitioner had received from the Commissioner exempting it from filing income tax returns.

The petitioner on August 12, 1944 and on May 17, 1945, as required by section 54 (f) of the Internal Revenue Code of 1939, filed with the respondent in the Office of the Collector of Internal Revenue at Detroit, Michigan, annual returns on Form 990 for the calendar years 1943 and 1944, respectively (Ex. 21 to Stipulated Facts; R. 20, 95-105). Attached to each of said returns was a statement of petitioners gross income for the year, its disbursements therefrom, and a statement of its assets and liabilities for the year.

As requested in respondent's revocation letter of July 16, 1945, petitioner filed corporation income and declared value excess profits tax returns and corporation excess profits tax returns for the calendar years 1943 and 1944 on October 26, 1945 (R. 18-19). These returns were filed under protest, and each return showed no computation of tax on the ground of the exemption from tax (Ex. 13 to Stipulated Facts; R. 71-76; Ex. 14 to Stipulated Facts; R. 77-82; Ex. 15 to Stipulated Facts; R. 83-90; Ex. 16 to Stipulated Facts; R. 91-94).

*With respect to the calendar year 1943; petitioner executed a Form 872 entitled "Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax" on August 23, 1948 and again on May 23, 1949 (Ex. C; R. 108-111). For the calendar year 1944, petitioner executed Form 872 on August 23, 1948 and again on May 23, 1949 (Ex. D; R. 112-115). The execution of the foregoing consents was requested by respondent for the purpose of extending the period of limitations upon the assessment of income and excess profits taxes for the calendar years 1943 and ~~1944~~ to June 30, 1950.

The respondent's statutory notice of deficiency for the years 1943 to 1947 inclusive was mailed to petitioner on February 2, 1950 (R. 2). While the statutory notice of deficiency with respect to the calendar years 1943 and 1944 was mailed to petitioner prior to June 30, 1950 (the limitations date set forth in the consents executed by the petitioner), the consent forms 872 for the years 1943 and 1944 were executed by petitioner subsequent to the expiration of three years from due dates for filing returns for 1943 and 1944, and also subsequent to the expiration of three years from the dates petitioner had filed with respondent returns on Form 990 for the calendar years 1943 and 1944.

SUMMARY OF ARGUMENT

I. PREPAID MEMBERSHIP DUES

Under section 41 of the Internal Revenue Code of 1939, petitioner is entitled to have its net income computed in accordance with the method of accounting regularly employed by it in keeping its books, unless that method did not clearly reflect income. Petitioner's method of accounting—under which prepaid membership dues are taken into income as earned—did clearly and correctly reflect its income. The method which the Commissioner seeks to substitute, the cash receipts method, demonstrably distorts petitioner's income.

Under petitioner's method of accounting, every single dollar of income was reflected in its books and, therefore, in its tax returns. The action taken by the Commissioner in petitioner's case is another illustration of his practice, which is exceeding all reasonable bounds, of disapproving accounting systems of long standing consistently applied by taxpayers, in an attempt by the Commissioner to collect in advance a tax which in due course will be paid tomorrow.

The Commissioner is in error in claiming that the "claim of right" doctrine, as applied by this Court in such cases as *Brown v. Helvering* (1934) 291 U. S. 193, justifies his rejection of petitioner's method of accounting. It is clear that this Court, without reversing or modifying any of its previous decisions with respect to "claim of right", can sustain petitioner's right to take prepaid membership dues into account for tax purposes in accordance with the method of accounting which petitioner adopted many years ago as best suited for its purposes. Moreover, the

Commissioner, in urging that petitioner's method of accounting violates the "claim of right" doctrine, is contending in effect that his regulations with respect to the treatment of prepaid income under long-term contracts, and other items, are invalid.

The repeal by Congress in 1955 of section 452 of the Internal Revenue Code of 1954, dealing with the tax treatment of prepaid income, did not indicate a Congressional approval of the Commissioner's position on prepaid income. Rather, Congress made it plain that it did not intend to disturb permissible accounting methods for prepaid income of the type involved in petitioner's case.

II. RETROACTIVE REVOCATION OF TAX EXEMPTION

An extreme case is presented when the Commissioner seeks to revoke, with retroactive effect, a ruling of tax exemption previously issued by him or by a predecessor Commissioner. Under the Commissioner's regulations, an organization claiming tax exemption is required to file an application for ruling so that the Commissioner can pass judgment upon the facts and law involved. When the Commissioner makes a determination—an administrative adjudication—that an organization is exempt from taxation, he advises the organization that it need not thereafter file tax returns so long as there is no change in its purposes, or manner of operation.

Whatever the power of the Commissioner may be to revoke with retroactive effect other types of rulings issued to taxpayers, and rulings published in the Internal Revenue Bulletin which some taxpayer may have read and relied upon, it seems clear that the Commissioner should be held not to have power to revoke, with retroactive effect, a ruling of tax exemption in the circumstances presented by petitioner's case. It would be a step backward in the

current endeavors to maintain public faith and confidence in our system of voluntary self-assessment of income tax if taxpayers are informed by this Court that the Commissioner, with impunity, can violate basic rules of fairness and equity in administering the tax laws.

There is a dearth of cases concerning the right of the Commissioner to revoke individualized rulings with retroactive effect. Among the authorities in support of petitioner is a recent decision of the Third Circuit Court of Appeals in *Lesavoy Foundation v. Commissioner*, — F. 2d — (November 21, 1956), in which the Commissioner was denied the right to revoke retroactively a ruling of tax exemption.

The Commissioner contends that he always has the right to correct, retroactively, a mistake of law made by a predecessor. Even if that be correct as a general proposition, the facts of petitioner's case qualify it as a most proper exception to any such general rule. The tax exempt rulings which the petitioner received in 1934 and 1938 did not involve a mistake of law which was plainly erroneous or in conflict with express statutory provisions.

The regulations of the Commissioner during 1943 and 1944 advised petitioner that, having established its tax exemption pursuant to the mandate of regulations, it need not thereafter file income tax returns. The attempt of the Commissioner in 1945 to deny petitioner the protection of those regulations was a violation of the principle enunciated by this Court in *Helvering v. R. J. Reynolds Tobacco Co.* (1939) 306 U. S. 110.

The Commissioner's reliance on section 3791(b) of the Internal Revenue Code of 1939 (relating to retroactive application of regulations and rulings) is misplaced. That section is not an obstacle to a decision in petitioner's favor.

The petitioner in good faith relied on the tax-exempt rulings issued to it until July 16, 1945, the date of the revocation of those rulings. Petitioner's reliance was with unmistakable detriment if the Commissioner had the right, as he insists, to make the 1945 revocation applicable to years then already past.

III. STATUTE OF LIMITATIONS

If it is found that the Commissioner had the power to revoke petitioner's tax-exempt rulings with retroactive effect, the statute of limitations would not, under the opinion below, restrain the Commissioner from the assessment of deficiencies against petitioner without limitation, because petitioner in reliance on the tax exempt rulings did not file the tax returns required of taxable organizations. Petitioner urges two grounds on which it can be properly held that the statute of limitations bars the assessment of any deficiency for the years 1943 and 1944.

First, as two lower courts have held, the statute of limitations commences to run on the due date for the filing of a return where the failure of the taxpayer to file had been induced by the Commissioner.

Second, the filing of Form 990 (the information return required to be filed by certain tax-exempt organizations) constitutes a return for the purpose of the statute of limitations, at least in a case where the taxpayer had an exemption ruling stating that it need not file tax returns on the form required of taxable organizations.

The statute of limitations often works a hardship and applies generally without regard to equities; but in petitioner's case, if the Commissioner had power to retroactively revoke petitioner's tax exemption, the statute of limitations will serve equity and eliminate the unfairness which necessarily accompanies retroactivity.

ARGUMENT

I.

MEMBERSHIP DUES

The Petitioner Was Entitled to Report Prepaid Membership Dues as Income When Earned, Rather Than When Received, in Accordance with the Method of Accounting Regularly Employed by Petitioner in Keeping Its Books.

A. Petitioner's method of accounting clearly reflected its income.

Under the statute and the regulations, petitioner is entitled to have its net income computed in accordance with the method of accounting which was regularly employed by petitioner in keeping books, unless that method did not clearly reflect income. Section 41 of the Internal Revenue Code of 1939 provides:

“The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income”

Section 29.41 of Regulations 111, applicable to the years here involved, provides in part:

“ . . . The time as of which any item of gross income or any deduction is to be accounted for

must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. *If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed* with respect to the time as of which items of gross income and deductions are to be accounted for * * * (Emphasis supplied.)

Despite the method of accounting regularly employed by petitioner in keeping its books, under which membership dues were taken into income as earned, the Commissioner recomputed petitioner's income by treating membership dues as income as of the time received. Although petitioner kept its books by the accrual method of accounting and filed its tax returns on that basis, the Commissioner has placed the petitioner strictly on the cash-receipts method insofar as membership dues are concerned.

It is recognized that the Commissioner contends in petitioner's case (although not consistently with his position in other cases mentioned later) that an accounting method will not clearly reflect income unless it applies the "claim of right" doctrine—as understood by the Commissioner. The Commissioner's misunderstanding and misapplication of that doctrine, as enunciated by this Court,⁸ is discussed later in this argument. But even though the Commissioner has mistaken notions as to what is included in the "claim of right" theory, the fact remains that he has rejected petitioner's method of accounting and substituted a method of his own. Under Section 41 of the Internal Revenue Code of 1939, the Commissioner has a right to compute petition-

⁸ North American Oil Consolidated v. Burnet (1932), 286 U. S. 417; Brown v. Helvering (1934), 291 U. S. 193; and other cases discussed infra.

er's net income under such method as in his opinion is proper, but only if petitioner's method fails to reflect income clearly. Thus, even though the claim of right doctrine is inapplicable in petitioner's case, the question remains whether petitioner's method of accounting more clearly reflects income than the method the Commissioner would substitute.

Petitioner's method of accounting with respect to membership dues serves a simple but sensible purpose—the income in one accounting period should be offset in the same accounting period by the expenses incurred in earning that income. If a member paid his dues on July 1, 1945, petitioner performed services for the member during the last six months of 1945 and during the first six months of 1946, and therefore earned the income during two separate accounting periods. Approximately half of the total expenses over the 12-month period were incurred in 1945 and deducted in the income tax return for 1945, and the balance of the expense in earning the income was incurred and deducted during 1946. It is quite obvious that if the net income derived from those dues is to be correctly computed in each of the two years during which the money was earned, one-half of the dues should be returned as gross income for 1945 and one-half for 1946. Petitioner's method of accounting did just that.

Under the Commissioner's cash receipts' method, 100% of the dues paid on July 1, 1945, would be included as gross income for 1945, even though only half of the expenses incurred in earning the dues were charged to 1945. That method clearly results in an absolute distortion of petitioner's earnings for both 1945 and 1946—an over-statement of the earnings for 1945, and an understatement of the earnings for the year 1946.

The patent correctness of petitioner's method of accounting, and the utter failure of the Commissioner's method to reflect income correctly in the case of prepaid dues, can be emphasized by a simple illustration. Let us assume the case of a new Automobile Club, organized in November 1956, which keeps its books on a calendar year basis. For the sake of simplicity, let us assume that 100 members joined the Club on December 1, 1956, and each paid \$12.00 annual dues in advance. The Club expects to incur expenses of 95¢ per month per member on the average (\$95 each month for the 100 members), or a total expense of \$1140.00 for the 12-months period. A total taxable income of \$60.00 would be realized out of the \$1200.00 collected in December from the members, or a profit of \$5.00 a month.

Under petitioner's method of accounting, the new Club would take \$100.00 (\$1 per member) into income for 1956, and after deducting expenses of \$95.00 incurred in December 1956, it would have a net income of \$5.00 for the year 1956 subject to tax. In the following year the remaining \$55.00 of the income would be earned and taxed.

But, under the Commissioner's method of accounting, the new Club would be required to pay a Federal income tax for 1956 on a fictitious taxable income of \$1105.00—\$1200.00 dues collected in December 1956, minus \$95.00 expenses incurred in that month. After paying the tax (on March 15, 1957) on that fictitious income, the new Club would not have enough money left to pay the monthly expenses of \$95.00 as they are incurred during 1957 in rendering services to its 100 members.

Clearly, the statute does not require such a result. To the contrary, it expressly provides for reaching a proper result. Section 42 (a) of the Internal Revenue Code of 1939 (Appendix p. 1a) provides in part:

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for *as of a different period*." (Emphasis supplied.)

While an accrual basis taxpayer quite commonly and properly includes an item in income *before* the year of receipt, the phrase "as of a different period" includes a period *after* the year of receipt, as well as a period *prior* to the year of receipt. If the statute had intended to eliminate (as a proper period in which cash receipts might be reported as gross income) a year following the year of receipt, then the phrase in section 42(a) would have simply read "as of an earlier period" in lieu of "as of a different period."

Indeed, the Commissioner himself has recognized in other areas (discussed later, pages 41 to 42) that income under section 42(a) can be properly reported after the year of receipt in the case of long term contracts, prepaid subscriptions, and certain other items.

Petitioner's method of accounting reached the very result which this Court has ascribed to the accrual method of accounting. In *United States v. Anderson*, (1926) 269 U. S. 422, this Court stated:

"It [the accrual method] was to enable taxpayers to keep their books and make their returns according to scientific accounting principles by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; * * *"

Furthermore, petitioner's method conforms to generally accepted accounting practices applied in the case of pre-paid dues. In the *Handbook of Accounting Methods* (1943 edition, edited by J. K. Lasser), the section dealing with accounting methods for clubs and fraternal organizations provides, on page 517:

"* * * Where dues are payable yearly in advance, and monthly income and expense statements are prepared, the proportionate amount of dues receivable for the month should be taken into income, and the unearned balance should be shown on the balance sheet as deferred income. * * *"

In the third edition (1943) of the *Accountants Handbook*, edited by W. A. Patton, the proper accounting method for revenue from services is stated, at page 114, as follows:

"Advances by the customer or the client are perhaps more common in the case of services than in the case of sale of goods * * *. Collections on account of services to be furnished in subsequent periods should, of course, be excluded from current revenue."

The Commissioner's method imposes upon petitioner a hybrid system of accounting—strictly the cash receipts method with respect to membership dues and the accrual basis with respect to other items of income and to all of its deductions. In *Commissioner of Internal Revenue v. South Texas Lumber Co.*, (1948) 333 U. S. 496 at p. 501 this Court stated:

"* * * a taxpayer generally cannot compute income taxes by reporting annual income on a cash basis and deductions on the accrual basis. Such a practice has been uniformly held inadmissible because it results in a distorted picture which makes a tax return fail truly to reflect net income."

Petitioner's method of accounting, appeals to just plain common sense. In addition, it conforms to the generally accepted accounting practices applied in the case of pre-paid dues. The Commissioner's hybrid method is condemned on both counts.

B. The Commissioner is unduly influenced by his desire to collect today a tax which in due course will be paid tomorrow.

Under petitioner's method of accounting, every single dollar of income was reflected in its books and, therefore, in its tax returns. The income from dues received in 1945, and earned in 1946, would not escape taxation under petitioners' method of accounting. Nevertheless, the Commissioner insists upon disrupting and ignoring petitioner's accounting system in order to tax for the year 1945 income which was earned in 1946 and reported in its 1946 return.

The Commissioner does not contend that the petitioner failed to apply its accounting method in a consistent manner from year to year. It is conceded that the petitioner did not adopt its accounting method for any tax reason. The method was adopted while petitioner was exempt from taxation and was not concerned with the filing of income tax returns.

On several occasions the lower courts have seen fit to criticize the Commissioner for refusing to accept an accounting system consistently employed by a taxpayer. In the case of *Pacific Grape Products Company v. Commissioner* (9th Cir., 1955) 219 F. 2d 862, the Ninth Circuit Court, in reversing a decision of the Tax Court which permitted the Commissioner to substitute his method of accounting for the method employed by the taxpayer, stated (page 869):

"Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it.
• • •"

In addition, the Court referred with approval to the dissenting opinion of six judges of the Tax Court, (17 T. C. 1097, 1110) written by Judge Oppen, who made the following comment with respect to the very practice which the Commissioner has employed in petitioner's case:

"The practice of disapproving consistent accounting systems of long standing seems to me to be exceeding all reasonable bounds. See Heer-Andres Investment Co., 17 T. C. 786. Methods of keeping records do not spring in glittering perfection from some unchangeable natural law but are devised to aid business men in maintaining sometimes intricate accounts. If reasonably adapted to that use they should not be condemned for some abstruse legal reason, but only when they fail to reflect income. There is no persuasive indication that such a condition exists here. On the contrary, a whole industry apparently has adopted the method used by petitioner.

"It will not do to say that respondent should not have disturbed petitioner's accounting method, but that since he has done so, we are powerless to do otherwise. As long as we continue to approve the imposition of theoretical criteria in so purely practical a field, respondent will go on attempting to

* The explanation of the Commissioner's action probably lies in the fact that the disapproval of the taxpayer's accounting method resulted in an asserted tax deficiency.

seize on such recurring fortuitous occasions to increase the revenue, even though he may actually accomplish the opposite. . . ." (Emphasis supplied.)

Similarly, in *Huntington Securities Corporation v. Busey* (6th Cir., 1940), 112 F. 2d 368 the Commissioner sought to substitute its method of valuing inventories for the method employed by the taxpayer. In denying the Commissioner the right to make the substitution, the Court said:

"The method used by appellant in valuing its inventories in our opinion clearly, but not accurately, reflected income, which is all that is required In our opinion the errors of the taxpayer did not bring into operation the wide discretion of the Commissioner to reject its method of valuing inventories which was approximately correct and to select one which was at variance with the taxpayer's consistent method."

If the number of members paying dues to petitioner had remained constant during all of the years in controversy, and if the amount of dues were neither increased nor decreased during that period, the petitioner's method of reporting income would have produced the same figure each year as the Commissioner's method. If the membership had been decreasing during that period, the petitioner's method of accounting would have shown a higher income than the method now urged by the Commissioner. No doubt, if petitioner's membership had been constant or decreasing during the period involved, the Commissioner would not have tried to substitute his method of accounting for the petitioner's method.

But in a year where the membership increases over the preceding year, or in a year when the dues are raised, the

Commissioner's cash method of accounting produces a larger (but unearned) income than petitioner's method. Since petitioner's membership did increase in every year from 1943 through 1947, except for the year 1947, we find the incentive and the motive for the Commissioner's action in casting aside petitioner's long-established method of accounting.'

Unnecessary harassment results from the Commissioner's practice of substituting his accounting method for the taxpayer's method whenever the Commissioner sees an opportunity to pick up a quick tax dollar. While a bird in the hand may be worth two in the bush to the man with a gun, that philosophy should not be the guiding spirit in administering a tax system which, far from being a "one-shot" affair, effects its toll from year to year. In the interest of decent tax administration—which should give some regard to avoiding harassment of taxpayers—the Commissioner should not be permitted to cast aside a long-established and consistently applied accounting method in the absence of a serious distortion of income. In petitioner's case there is a serious distortion of income only if the Commissioner's cash receipts method of accounting is substituted for the method which petitioner adopted—without regard to tax consequences—as best suited to its activities.

The Commissioner's rejection of petitioner's method of accounting violates the letter and spirit of his regulations (Sec. 29.41-3 of Regulations 111) which state:

' If it had not been for a raise in dues from \$10 to \$12 effective in October 1946, the petitioner's method of reporting income for the year 1947, when membership decreased by about 16,000 from the 1946 figure (R. 5), petitioner's method of accounting would have produced a greater income for 1947 than the Commissioner's cash method.

"It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose."

C. The Commissioner erred in applying the claim of right doctrine in petitioner's case.

(1) *Decisions of this Court on claim of right.*

The Commissioner's action in placing the petitioner on the cash basis with respect to membership dues was sustained by both the Tax Court (R. 144, 160) and the Sixth Circuit Court of Appeals (R. 190, 200). The Sixth Circuit stated that the determination of the Commissioner that membership dues should be included in income for the year in which they were received "was clearly correct", and cited three decisions of this Court as being in support of its conclusion. *North American Oil Consolidated v. Burnet*, (1932) 286 U. S. 417; *Security Flour Mills Company v. Commissioner of Internal Revenue* (1944) 321 U. S. 281; and *United States v. Lewis*, (1951) 340 U. S. 590.

The Sixth Circuit opinion made no reference whatever to the decision and opinion of the Tenth Circuit Court of Appeals in *Beacon Publishing Company v. Commissioner*, (10th Cir., 1955) 218 F. 2d 697, even though the latter opinion (upon which the petitioner strongly relied in the Circuit Court below) made it clear that the Commissioner's application of the claim of right doctrine is not supported by the decisions of this Court.*

* In its brief submitted to the Sixth Circuit, the respondent contended that the decision in the Beacon Publishing case was incorrect, but he did not file a petition with this court for a writ of certiorari.

The claim of right doctrine appears to have been first applied in a tax case by this Court in *North American Oil Consolidated v. Burnet, supra*. In that case the taxpayer in 1917 received money representing profits earned in 1916 from certain oil land. A dispute over title to the oil land was not settled until 1922. The taxpayer contended that the income was taxable either in 1916, the year it was earned, or in 1922 when the litigation was settled in its favor. This Court, in holding that income was taxable in the year received stated the "claim of right" doctrine as follows:

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return (for tax purposes) even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. . . ."

It is clear that the facts of this case are not applicable by analogy to petitioner's case. When petitioner received money for membership dues none of the money had been earned. In earning that money petitioner had to make expenditures in the year following receipt of the cash. But in the *North American Oil* case the money received in 1917 had already been earned. No expenses were incurred after the receipt of the money in earning that income.

The *North American Oil* decision was cited in *Brown v. Helvering* (1934) 291 U. S. 193, where the taxpayer was a general agent for insurance companies, and received commissions on policies whose terms extended beyond one year. If a policy was cancelled, Brown was required to refund a proportionate amount of the commission to the insurance company. Under his method of accounting, he treated the commissions as income when received, and

in the event a policy was cancelled, he deducted the refund as an expense in the year of refund. He sought to change that method of accounting so as to charge to expense in the year in which a commission was received an estimated reserve to recover refunds that would occur in the future. With respect to that contention this Court held that Brown was not entitled to take a current deduction for the refunds he might have to make in subsequent years.

Brown made an alternative contention before the Court—that the cash commission received should be taken up as gross income on a deferred basis, pro rata over the life of the policy. As to that, this Court made two pertinent observations. In the first place, the Court stated that Brown had never kept his books on that basis. In the second place, the Court said (291 U. S. 193, 204):

“ . . . Moreover, the Board concluded that there is no proof that the overriding commissions contain any element of compensation for services to be rendered in future years. . . . ”

The Brown case merely informs us, as did the *North American Oil* case, *supra*, that it is immaterial that the taxpayer may have to refund all or part of money he has received under a claim of right and without restriction on use. The case does not stand for the proposition urged by the Commissioner that it is immaterial, when cash is received before it is earned, that the expenses of earning the income will be incurred after the year of receipt of the cash. The *Brown* case was decided on the assumption that there were no services to be rendered after the money had been received.

In *Security Flour Mills Company v. Commissioner*, *supra*, the taxpayer added a processing tax, which it was

contesting, to the selling price of flour sold in 1935. In subsequent years the taxpayer refunded to its customers portions of the processing tax collected in 1935 but not remitted to the United States, and claimed a deduction should be allowed for the year 1935 instead of for the years of the refunds. This Court held that the deductions were not allowable for the year 1935 and that the entire selling price of the flour in 1935, including the added tax, was taken into account in computing income for the year of the sale. Here again, as in *Brown v. Helvering, supra*, the taxpayer did not, after the year of receipt of the income in question, deliver goods or perform services to earn that income.

The claim of right doctrine was applied by this Court in *United States v. Lewis, supra* and in *Healy v. Commissioner of Internal Revenue*, (1953) 345 U. S. 278. In the *Lewis* case, the taxpayer in 1944 received a bonus as compensation for services rendered, as an employee. In a subsequent year he was required to return a part of the bonus to his employer. In the *Healy* case, the taxpayer had received a salary from a closely held corporation in which he was an officer and stockholder. Subsequently, and after the corporation had been liquidated, the Commissioner disallowed the deduction by the corporation of part of the salary as being unreasonable compensation. *Healy*, as a transferee, had to pay the additional corporate tax attributable to the disallowance of the excessive salary payment, and he contended that the amount of the salary he received should be reduced, for tax purposes, by the amount of the corporate tax he paid. He also contended, unsuccessfully, that he received the salary under a restriction as to use.

In both the *Lewis* and *Healy* cases the compensation received by the taxpayers had been earned at the time of the

receipt. No services were rendered or expenses incurred after the compensation was received, without restriction on its use. This Court merely applied the rule previously announced in the *North American Oil* and *Brown* cases, that money already earned, and received without restriction as to use is taxable when received despite the fact that all or part of the money may have to be or was returned, for one reason or another, in a year subsequent to its receipt.

From the foregoing, it is quite apparent that the Commissioner, and the lower courts in this case, are in error in contending that the claim of right doctrine as applied by this Court requires that the prepaid membership dues received by petitioner, to the extent that they were earned in the year following their receipt, were nevertheless taxable when received. It is clear that this Court, without reversing or modifying any of its previous decisions, can sustain petitioner's contention that it is entitled to take prepaid membership dues into account for tax purposes in accordance with its long established method of accounting.

(2) *The Beacon Publishing Company case.*

The facts in *Beacon Publishing Company v. Commissioner*, (10th Cir., 1955) 218 F. 2d 697 are indistinguishable in principle from those in petitioner's case. The Tax Court (21 T. C. 610, 611) stated that the question was whether the amount of prepaid subscriptions received by a publishing company is taxable in the year of receipt, or whether the prepaid amount could be deferred for taxation over the period of the subscriptions. The Commissioner's position was that the claim of right doctrine applied, notwithstanding that the expenses of earning the prepaid income would be incurred following the year of receipt.

The Tax Court agreed. The Tenth Circuit Court of Appeals reversed.

In the *Beacon* case, the taxpayer received prepaid subscriptions for a period varying from thirty days to five years. All of the expense in earning the prepaid subscriptions was not incurred in one year, just as in petitioner's case all the expenses of earning membership dues was not incurred in one year. When a prepaid subscription was received, it was credited to an account entitled "Prepaid Subscriptions", just as the petitioner credited the receipt of dues to the account designated "Unearned Membership Dues."

The Tenth Circuit in the *Beacon* case noted that the Tax Court had applied the "claim of right" doctrine to support its decision, and that the Commissioner on brief had specifically stated that the "claim of right" doctrine was "the legal theory underlying the Tax Court's decision." The Circuit Court agreed that taxable funds received under a "claim of right" are returnable in the year of receipt. But it disagreed with the Commissioner's position that the "claim of right" doctrine applies to prepaid receipts where the taxpayer keeps his books on the accrual basis of accounting and the prepayments have to be earned in the future. The Court in rejecting the Commissioner's position stated (page 701):

"* * * This would produce an incongruous result. It would permit the collection of taxes during periods not contemplated by the accrual method of accounting, and force the taxpayer into a cash receipts basis, for all prepaid items. *Such was not the reasoning or the purpose of the cases relied upon.* Such an application of the rule requires the taxpayer to report its prepaid income on a cash basis and to accrue its deductions. It creates a hybrid bookkeeping system and results in a tax

return which does not clearly reflect income. * * *.”
(Emphasis supplied.)

The Tenth Circuit therefore, validly distinguished situations involving “claim of right” cases where there is a dispute as to ownership of taxable funds or, for other reasons, the contingency exists that part or all of such funds may have to be returned in a subsequent year, from cases involving prepaid income. As the Court observed, the *Beacon* case was not a situation where the Commissioner properly exercised his discretion to insist on an accounting method clearly reflecting income, but rather a case where the Commissioner improperly applied a legal principle.

In holding that the Tax Court was in error as to the tax treatment of prepaid income of the kind presented in petitioner's case, the Circuit Court stated (page 700):

“It gave no consideration to the fact that the taxpayer accounts for its income under the accrual method and will not incur the expenses necessary to earn the income until the following taxable years. In other words, the Tax Court holds that advance payments received by a taxpayer, which are subject to income tax, must be returned in the year of receipt if owned or claimed by the taxpayer, regardless of the method of accounting which has been adopted, or when the funds are actually earned. Such application of the rule limits the accrual method to that class of cases where money has been earned and the right to it has been fixed, but the receipt is delayed to a subsequent taxable period. The application of the doctrine would in most cases result in a distortion of an accrual taxpayer's true income.”

(3) *Recent decisions which conform to the Beacon Publishing Company case.*

The Fifth Circuit Court in *Schuessler, et al., v. Commissioner* (1956) 230 F. 2d 722, reached the same conclusion as the Tenth Circuit in the *Beacon Publishing Company* case in distinguishing and holding inapplicable the "claim of right" doctrine to the prepayment of income to be earned in subsequent years.

In the *Schuessler* case the taxpayer sold furnaces. Included in the sales price was the guarantee to turn on and off such furnaces for the next five years. The taxpayer reported the sales price in the year of receipt but deferred taxation on the full amount by setting up and deducting in the year of receipt a reserve for the estimated expenses to be incurred during the following five years. The Tax Court recognized that the case presented the same issue as in the *Beacon Publishing* case, for the reason that the taxpayer was attempting to defer, as income, the sales price which he received for the furnaces, to the years in which he was obligated to perform the services required by the sales contract. The Tax Court, in sustaining the Commissioner, applied the "claim of right" doctrine, stating (24 T. C. 247, 249):

"* * * the *Beacon Publishing Company* case does not appear to us to conform to the firmly established 'claim of right' doctrine governing the receipt of income and its taxability in the year in which received."

The Fifth Circuit analyzed the petitioner's method of accounting and concluded that it came much closer to giving an accurate picture of his income than the method contended for by the Commissioner and stated (page 723):

"We find that not only does it [taxpayer's accounting method] not offend any statutory requirement, but, in fact, we think it is in accord with the language and intent of the law. Clearly what is sought by this statute is an accounting method that most accurately reflects the taxpayer's income on an annual accounting basis

"The case of *Beacon Publishing Co. v. Commissioner* is considered by both parties here and was noted by the Tax Court as of special significance. That case involved the treatment of prepaid income received by the *Beacon Publishing Co.* covering subscriptions to be furnished in subsequent years

"We prefer the reasoning as well as the conclusion reached by the Court in the Tenth Circuit. There the opinion correctly, we think, disposed of the 'claim of right' theory advanced by the Commissioner and adopted by the Tax Court in this type of case."

See also the decision of the Ninth Circuit in *Pacific Grape Products Company v. Commissioner* (1955) 219 F. 2d 862, (quoted from on page 29 of this brief) and the decision of the Sixth Circuit in *Henry Hilinski v. Commissioner* (1956) 237 F. 2d 703. In both cases the Circuit Courts, reversing the Tax Court, held that the Commissioner was in error in refusing to accept the taxpayer's treatment on its books of expenses to be incurred. In both cases the taxpayer's books were designed to bring into one accounting period the income and related expenses.

The Solicitor General did not authorize the filing of a petition for certiorari in the foregoing cases or in the *Beacon Publishing Company* case.

(4) The Commissioner has been inconsistent with respect to his treatment of prepaid income.

The Commissioner's treatment of prepaid dues in petitioner's case is contrary to his position in certain other areas which are indistinguishable in principle from prepaid dues. In *I. T. 3369*, 1940-1, C. B. 46, the Commissioner noted that two methods of accounting are followed by publishers of periodicals. Under the first method, the publisher reports all of the income from prepaid subscriptions in the year of receipt. Under the second method, the publisher reports only an aliquot part of the subscription price for each year of the subscription period. The Commissioner ruled:

"It is held that where a publisher of periodicals has, over a period of years, followed consistently either of the two methods outlined above, he may continue to file his returns on such basis, he will not be required to change to the other basis, and his net income for the past years will not be re-determined on such other basis."

In *I. T. 2080*, III-2, C. B. 48, (1924) the taxpayer was engaged in the business of running various cruises and tours, the receipts for which were principally received in the last two months of the year, while the expenses were incurred in the following year. The Bureau ruled that in order for the taxpayer to show his taxable net income properly, he should file his income tax returns in accordance with the accrual method of accounting so that income received and the expenses incurred in earning it would be reflected in the same accounting period.

The Commissioner's treatment of bond premium is a striking example—in contrast to his position in petitioner's case—of permitting amounts received in one year (with-

out any restriction as to use) to be reported as income in years following the year of receipt. Sec. 29.22(a)-17 (2) (a) of Regulations 111 provides:

"If, subsequent to February 28, 1913, bonds are issued by a corporation at a premium, the net amount of such premium is *gain or income which should be prorated or amortized over the life of the bonds* * * *." (Emphasis supplied.)

Also, with no statutory authority except for section 42(a) (discussed at page 26, *supra*), the Commissioner, by regulation (section 29.42-4, Regulations 111), has approved two methods of accounting for the profits derived from long term contracts, either of which will permit gross income to be reported as taxable income in a year *after* the year of receipt. If the "completed contract method of accounting" is adopted for reporting income derived from long term contracts, many payments received by the contractor are not included in gross income until *after* the year of receipt.

If it be true, as the Commissioner contends, that the "claim of right" doctrine prohibits proper accounting for prepaid dues income, it would appear that the Commissioner is also contending that his regulations with respect to bond premium, long term contracts, as well as *I. T. 3369, supra*, are invalid.

D. The Significance of the Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954.

Sections 452 and 462 of the Internal Revenue Code of 1954 were intended to settle for 1954 and subsequent years the controversies which have arisen over the tax treatment of prepaid income and taxpayer's reserves for estimated expenses. Section 452, dealing with prepaid in-

come, specifically reached the same result which the Tenth Circuit reached in the *Beacon Publishing Company*, case, *supra*, and which the Sixth Circuit refused to reach in petitioner's case. But section 452 covered many types of prepaid income which present problems not involved in petitioner's case, and it can be noted that section 452 did not provide that the taxpayer could report prepaid income on a deferred basis only if he keeps his books in that manner. Section 462 specifically allowed a deduction for a reserve for estimated expenses of the type involved in the *Schuessler* case, *supra*, as well as in other situations.

In 1955 sections 452 and 462 of the Internal Revenue Code of 1954 were repealed (Public Law No. 74, 84th Cong. 1st Sess.). The Ways and Means Committee, in recommending the repeal, stated (H. Rep. No. 293, 84th Congr. 1st Sess., p. 4):

"Your committee in repealing sections 452 and 462 does not intend to disturb prior law as it affected permissible accrual accounting provisions for tax purposes, including the treatment of prepaid newspaper subscriptions."

The Secretary of the Treasury advised the Chairman of the Committee on Ways and Means as follows (H. Rep. 293, *supra*, p. 295):

"Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 Code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner*, (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

Similar statements were made by the Senate Finance Committee in its report on Public Law No. 74 (Senate Report 372, 84th Congress, first session, p. 5-6). It is, therefore, quite clear that so far as Congress is concerned, it has not discouraged a decision in petitioner's favor and certainly has not encouraged or in any manner approved the Commissioner's attempt to reject, for tax purposes, petitioner's method of accounting for prepaid membership dues.

II.

THE RETROACTIVE REVOCATION OF PETITIONER'S EXEMPTION WAS ARBITRARY AND BEYOND THE COMMISSIONER'S POWER

A. In General: The Nature of the Issue.

The regulations prescribed by the Commissioner have, for many years, required that an organization claiming a tax-exempt status must file an application for a ruling as to its tax-exempt status.* Article 101-1 of Regulations 94 (Appendix A, pp. 5a to 6a) in force during 1938 when the Commissioner ruled for the second time (R. 59) that petitioner was exempt from taxation, provided:

"A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the

* Form 1025 (the affidavit for organizations claiming exemption) provides: "Unless the Commissioner has determined that an organization is exempt, it must prepare and file a complete income tax return for each taxable year of its existence, * * * As soon as practicable after the information and data are received, the organization will be advised of the Commissioner's determination; and, if it is held to be exempt, no further returns of income will be required" (R. 64, 65).

*tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption * * **

"The Collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

"When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created." (Emphasis supplied.)

While the Commissioner has not published the number of rulings he has issued pursuant to the mandate of these regulations (and corresponding provisions of regulations applicable to other years), I. R. S. Publication No. 78 (a Cumulative List, revised to October 31, 1954) lists over 36,000 organizations which have been held by the Commissioner to be tax exempt organizations of the type to which contributions are deductible. No figures are available which would indicate the number of other organizations (labor or agricultural associations, fraternal societies, social clubs, business leagues, farmers cooperatives, etc.) which have received rulings from the Commissioner declaring they are exempt from taxation, but no doubt the number is very large.

Petitioner was one of the many thousands to whom the Commissioner, in accordance with the regulations, issued a ruling as to tax exempt status. In 1934, and again in 1938, the Commissioner of Internal Revenue—after “careful” consideration of the facts as to the organization of petitioner, its purposes, and manner of operation—ruled that petitioner was exempt from income taxation and was, therefore, not required to file income tax returns (Statement, *supra*, pages 7 to 11).

Neither the ruling of 1934 or 1938 was of general application, each was concerned only with the income tax status of petitioner.¹⁰ Neither ruling was published in the Internal Revenue Bulletin.

In 1945 a successor Commissioner of Internal Revenue concluded that the prior rulings given to petitioner in 1934 and 1938 were erroneous. His conclusion that the prior rulings were erroneous was not based on any amendment to section 101(9) of the Internal Revenue Code of 1939 (or corresponding provisions of prior law), or upon any change in the regulations interpreting section 101(9).¹¹ The Commissioner did not claim that petitioner obtained its prior rulings by reason of any misrepresentation or concealment of the facts in any respect, and there was no contention that petitioner had failed to operate

¹⁰ To use Judge Goodrich's characterization of this type of ruling in the recent case of the Lesavoy Foundation v. Commissioner of Internal Revenue, — F. 2d — (3rd Cir., decided November 21, 1956, 57-1 USTC Par. 9229) the rulings in petitioner's case were “individualized” rulings.

¹¹ In Keystone Automobile Club v. Commissioner, 181 F. 2d 402 (3d Cir. 1950) it was stated: “From the very beginning Treasury regulations have interpreted section 101(9) as applicable to social clubs and social clubs only.”

in the manner contemplated when the rulings of exemption were issued in 1934 and 1938.

The reason for the determination that the prior rulings were erroneous was that the Commissioner in 1945 held a different view of the statute than did the Commissioner in 1934 and 1938. The position of the Commissioner in 1945 was that since fellowship between the petitioner's members did not play a material part in the life of the organization, the Commissioner, in 1934 and 1938, was wrong in determining that petitioner was exempt from taxation.

On July 16th, 1945, the Commissioner wrote a letter (R. 66, 67) to petitioner revoking the prior ruling letters dated June 11, 1934 and July 5, 1938. This revocation was not merely prospective. The Commissioner, without any further inquiry as to the facts and without giving petitioner an opportunity for a conference, ordered petitioner to file income and excess profits tax returns for two years then already passed—the years 1943 and 1944.

The Commissioner's position is clear. He contends that he has the power, whenever he determines that he (or his predecessor) has issued an erroneous ruling to a taxpayer, to revoke that ruling with complete retroactive effect. It does not matter, in the opinion of the Commissioner, that the only error in the case was committed by him or by his predecessor. As the Commissioner sees it, the only protection the taxpayer has (aside from the statute of limitations) is the Commissioner's own sense of fairness in determining the extent to which the revocation of the ruling should be without retroactive effect.¹²

¹² In the Lesavoy Foundation case, discussed *infra* at page 53, the Commissioner's sense of fairness permitted him to revoke a tax exempt ruling retroactively with the result that the Commissioner would have taken all of the assets of the Foundation. The Third Circuit Court came to the rescue.

The Commissioner draws no distinction between a ruling of tax exempt status—which a taxpayer is required to apply for under the regulations—and other types of rulings.¹³

After the Tax Court's decision was rendered in petitioner's case on September 23, 1953, the Commissioner announced his policy with respect to retroactivity in two separate rulings. Rev. Rul. 54-164, 1954-1 C. B. 88 (pertinent text is set forth in Appendix B, page 11a) dealt with tax exempt organizations; and Rev. Rul. 54-172, 1954-1 C. B. 394 (pertinent text is set forth in Appendix B, page 12a) dealt with other types of individualized rulings and with rulings published in the Internal Revenue Bulletin. A reading of these rulings reveals that under the Commissioner's view his power to revoke with retroactive effect a ruling of tax-exempt status issued to a particular organization is no less than his power to revoke retroactively a ruling published in the Internal Revenue Bulletin, which some taxpayer may have read and relied upon. A ruling issued on the unsolicited¹⁴ request of a taxpayer

¹³ The Commissioner apparently makes one exception. In Rev. Rul. 54-172, 1954-1 C. B. 394, page 401 he states:

“.07 Under the provisions of section 1108(b) of the Revenue Act of 1926 (which is regarded as still in effect even though not incorporated in the Internal Revenue Code), a ruling holding that the sale or lease of a particular article is subject to the manufacturers' excise or the retailers' excise tax must be limited in its retroactive application in any case, where (1) such ruling reverses a prior ruling holding the particular article to be nontaxable, and (2) the taxpayer in reliance upon such ruling parted with possession or ownership of such article without passing the tax on to his customer.”

¹⁴ In *James Couzens*, 11 B. T. A. 1040 (1928) the taxpayer had asked for a ruling as to the valuation of Ford Motor stock as of March 1, 1913. In holding that the Commissioner was not bound by the ruling given, Judge Van Fossan, concurring, referred (p. 1174) to this type of ruling as one granted “as a courtesy” to the taxpayer.

as to the tax treatment of some item; is, apparently, in the eyes of the Commissioner, of equal dignity to a ruling of tax exemption. He treats them alike so far as his policy of retroactive revocation is concerned.

So far as petitioner's case is concerned, the Commissioner argues that petitioner was never, under the statute, exempt from income tax, and that the rulings issued to the contrary in 1934 and 1938 cannot create an exemption not provided by the statute. In such a case, the Commissioner contends that he is not limited to a correction of the erroneous rulings with prospective effect only, but that he has the power to act as if the rulings had never been issued. In petitioner's case, the Commissioner could have in 1945, under his view of the law, retroactively revoked the previous rulings without limitation.¹⁵

The Commissioner's position is based, fundamentally, on a belief that he is immune from all doctrines of estoppel, and that section 3791 (b) of the Internal Revenue Code of 1939 (Appendix A, p. 3.4) recognizes such immunity. While there are some court decisions which give direct support to the Commissioner's position,¹⁶ the better cases (hereafter discussed) as to the contrary.

¹⁵ Petitioner did not file returns for any of the years prior to 1943. Since the Commissioner contends in this case that the statute of limitations cannot start to run before a return is filed, the Commissioner, under his position, was restrained only by his sense of fairness.

¹⁶ Quite clearly, decisions of this Court to the effect that the Government cannot be estopped by the unauthorized acts of its agents are not applicable here. See Utah Power & Light Co. v. U. S., 243 U. S. 389 (a non-tax case) and Merrill v. Federal Crop Insurance Corporation, 322 U. S. 380 (non-tax case). The Commissioner of Internal Revenue, in issuing rulings of tax exempt status of organizations, is not performing an unauthorized act.

In some instances the lower courts (assuming that the Commissioner was immune from estoppel) have applied the immunity doctrine reluctantly, and with misgivings. For example, in *Walker-Hill Co. v. U. S.*, (7th Cir. 1947) 162 F. 2d 259, the Commissioner refused to honor a previous ruling given to the taxpayer by the Alcohol Tax Unit. In holding that the Unit's letter did not constitute an estoppel against the Government, the court observed:

"It never gives a satisfactory, reassuring feeling, however, for the Government to repudiate the act of one of its agents performed in the course of his duties. The rule against estoppel, however, is based upon the assumption that the Government's welfare, being of greater importance, outweighs individual injustices in particular cases."

In *Stockstrom v. Commissioner*, 190 F. 2d 283, (App. D. C., 1951), the Court found an estoppel against the Commissioner. While Circuit Judge Prettyman dissented from the holding of the majority, he commented as follows:

"I wish the law were as they find it to be, because it is my belief that the Government ought to set a high standard in its dealings and relationships with citizens and that the word of a duly authorized Government agent, acting within the scope of his authority ought to be as good as a government bond."

In a most readable and scholarly article entitled "Estoppel Against the Government" (Raoul Berger, 21 Univ. of Chicago Law Review 680, 682 (1954)) the author states with respect to estoppel in tax cases:¹⁷

¹⁷ The author concludes his article (at page 707) as follows: "Repudiation of representations is dirty business, no less at the hands of the government than of its citizens. Hence the claim of immunity for govern-

“... There is also need to re-examine the rule that the government may repudiate an official interpretation by reliance on the ‘mistake of law’ doctrine, and to review the principles governing the right of an administrative officer to overrule the decision of a predecessor. * * * It may be added that the problem of governmental immunity from estoppel is most acute in the tax field because of (1) the great volume of tax cases, (2) the unduly cautious application of estoppel to the government in such cases, and (3) statutory ambiguities which complicate the estoppel-immunity problem in the tax field.”

A decision on the issue presented in petitioner's case cannot settle all questions with respect to the Commissioner's power to apply his rulings retroactively.¹⁸ But since retro-

(Continued from preceding page)

mental repudiation is tolerable only to the extent that it rests on inescapable compulsions arising out of the needs of government. * * * The claim of the government to an immunity from estoppel is in fact a claim to exemption from the requirements of morals and justice. As such, it needs to be jealously scrutinized at every step. Confidence in the fairness of the government cements our social institutions. No pinch-penny enrichment of the government can compensate for an impairment of that confidence, for the affront to morals and justice involved in the repudiation of a governmental representation.”

¹⁸ In a note, *The Emerging Concept of Tax Estoppel*, 40 *Virginia Law Review* 313, it was concluded:

“The conclusion must be that something is emerging in this area which may be called ‘tax estoppel’ for want of a better term. The development of this doctrine seems salutary. It is proper that the Commissioner's broad statutory authority should have imposed upon it some equitable limitations. The body of case law that is evolving is an answer to this need. It can be no surprise to any-

(Continued on following page)

active revocation of a ruling of tax exempt status is such an extreme case, a decision in favor of retroactive action by the Commissioner would be a step backward in the current endeavors to instill public faith and confidence in the Internal Revenue Service. "A victory may have implications which in future cases will cost the Treasury more than a defeat."¹⁹

Since our income tax system rests to a great and unique extent on voluntary compliance by the taxpayer in the self-assessment of the tax, it is extremely important that the taxpayer understands that he will be dealt with fairly by the government.²⁰ If the taxpayer knows that the Commissioner can and will violate basic rules of fairness in administering the tax law, the continued success of the system of voluntary self-assessment is placed in jeopardy. Certainly if the courts inform the taxpayer that the Commissioner need not turn square corners in dealing with him,

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one in the profession that, where the equities of the taxpayer are placed against the authority of the sovereign in so vital an area as taxation, the law is emerging case by case. No case, unless its facts be almost entirely duplicated in a later situation, can be of much authority.

"The process is slow, hesitant, and defies logical organization or codification. It is evident, however, that equitable limitations against the Commissioner are developing, and the result is to be welcomed by all who would place justice above revenue."

¹⁹ Mr. Justice Jackson, dissenting, in Arrowsmith v. Commissioner, 344 U. S. 6, (1952).

²⁰ Mr. Daniel Webster observed that our government should take care in every part of the system "not only to do right, but to satisfy the community that right is done." 5 Writings and Speeches of Daniel Webster 163, quoted by Mr. Justice Frankfurter, concurring, in Joint Anti-Fascist Comm. v. McGrath, 341 U. S. 123, 172 n. 19 (1951).

it may be too much to expect the taxpayer to turn square corners when he deals with the Commissioner.²¹

B. Authorities in Support of Petitioner's Position.

In the case of *Lesavoy Foundation v. Commissioner*, ... F. (2d) ... (3d Cir. 1956, 57-1 U. S. T. C. 9229), the Commissioner in 1945 issued a ruling to the foundation that it was exempt from taxation under section 101(6) of the Internal Revenue Code of 1939. In 1951 the Commissioner revoked the ruling retroactively to the year 1946, during which year the foundation had acquired a mill which manufactured cotton yarn and cloth. The Commissioner claimed that the foundation in 1946 departed from its exempt purposes and was used in part as a means of furthering business enterprises of the donor of the foundation. The Tax Court sustained the deficiency asserted by the Commissioner.

The Third Circuit in reversing the Tax Court did not decide the question as to whether the revocation of the tax exempt ruling was correct insofar as prospective applica-

²¹ "Mr. Justice Holmes made the often quoted statement that 'Men must turn square corners when they deal with the Government'; but, subsequently, referring to this observation, Judge McDermott, of the Tenth Circuit, in *Howbert v. Penrose*, 38 F. 2d, 577, 581, added that 'government ought to turn square corners when dealing with its citizens.'" From the dissenting opinion of Judge McAllister in the case below (R. 200, 205).

In *Menges v. Dentler* (1859) 33 Pa. 495, 500, the Court said: "Men naturally trust in their government, and ought to do so, and they ought not to suffer for it * * *. Indeed, it is an essential principle of government; for, if the right to trust to the highest governmental functionaries is denied, and such trust is unprotected, every man is bound to question every act of government that affects him, and to resist whatever he does not approve—a doctrine that would make government impossible."

tion was concerned. On that point Judge Goodrich stated for the Court:

"The reason we do not need to go into the questions just stated is that we think the Commissioner went beyond his authority in revoking the certificate of exemption retroactively. We quite realize that the Commissioner may change his mind when he believes he has made a mistake in a matter of fact or law. Our own decision in *Keystone Automobile Club v. Commissioner*, 181 F. 2d 402 (3d Cir. 1950) recognizes this point fully and that point is sustained by abundant authority. But it is quite a different matter to say that having once changed his mind the Commissioner may arbitrarily and without limit have the effect of that change go back over previous years during which the taxpayer operated under the previous ruling."

Judge Goodrich then stated that there is a "dearth of cases" involving retroactive revocation of individualized taxpayers' rulings, and went on to say:

"This is so because the Commissioner has almost invariably followed a policy of honoring his rulings and making changes prospective only, since the much criticized case of *James Couzens*, 11 B. T. A. 1040 (1928) (Contra, *Woodworth v. Kales*, 26 F. 2d 178 (6th Cir. 1928)). Indeed, this policy has been codified by one of the Commissioner's own rulings:

"The few authorities that there are concerning individualized rulings are not unanimous. The point has had the most attention in the Sixth Circuit. The latest decision of that Court in *Automobile Club of Michigan v. Commissioner*, 230 F. 2d 585 (6th Cir. 1956), cert. granted, 25 U. S. L. Week 3095 (U. S. Oct. 8, 1956) (No. 89), discusses previous rulings and comes out with elaborate opinions both supporting and against the Commissioner's action" (Footnotes omitted.)

After reference to the holding of the majority opinion of the Sixth Circuit in petitioner's case, Judge Goodrich stated that "*on the other hand*" there is respectable authority that the Commissioner may not retroactively revoke an individualized taxpayer's ruling, and cited two earlier decisions of the Sixth Circuit, *H. S. D. Company v. Kavanagh*, 191 F. 2d 831 (1951) and *Woodworth v. Kales*, 26 F. 2d 178 (1928). Inasmuch as the Sixth Circuit had also decided petitioner's case, he stated that the Sixth Circuit attempted, in petitioner's case, to distinguish it from the *H. S. D.* and *Woodworth* cases, "but we find the distinction doubtful".

In its opinion the Third Circuit expressed the view that section 3791(b) of the Internal Revenue Code of 1939 (discussed later in this argument) "gives the Commissioner discretionary power to determine the extent of the retroactivity in a given case". But the Court then concluded that the Commissioner had gone "beyond the bounds of permissible discretion" in the retroactive revocation of the foundation's tax exempt status. The Commissioner had applied his revocation retroactively for five years. There was no suggestion however, that a lesser amount of retroactivity would have been sanctioned by the Court.

In its brief to the Sixth Circuit petitioner relied on the prior decisions of that court in the cases of *H. S. D. Company v. Kavanagh*, *supra*, and *Woodworth v. Kales*, *supra*. In the *Kales* case the taxpayer, before making a sale of Ford Motor Company stock, obtained a ruling from the Commissioner as to the fair market value of the stock as of March 1, 1913. After the taxpayer filed a return reporting gain on the sale, the Commissioner assessed an additional tax on the basis of a lower valuation which he had placed on the value of the Ford stock. The Sixth Circuit held that the second Commissioner was without authority to revoke

the determination of the former Commissioner. A contrary conclusion, on the same set of facts involving another taxpayer, had been reached by the Board of Tax Appeals in the case of *James Couzens*, 11 B. T. A. 1040 (1928).²²

The *H. S. D. Company* case involved the retroactive revocation of a tax exempt ruling. The taxpayer had received a ruling from the Commissioner in 1944, and again in 1946, that two employees' trusts created by the taxpayer were exempt from taxation under section 165 of the Internal Revenue Code of 1939. In 1948 a successor Commissioner revoked the prior rulings retroactively to the date of the creation of the trusts. The first Commissioner had determined that the terms of the trusts did not discriminate in favor of highly compensated employees. The second Commissioner did not agree with the conclusion of his predecessor. The Sixth Circuit held that the second Commissioner was estopped and bound by the prior decision relied upon by the taxpayer, whether or not the prior decision was correct.

The *H. S. D. Company*, in establishing the tax-exempt status of the trusts, had submitted to the first Commissioner the information called for by regulations promulgated under section 165 of the Internal Revenue Code of 1939, just as the petitioner in establishing its own tax exempt status submitted the information called for by the regulations under section 101. The Sixth Circuit, in its decision in the *H. S. D. Company* case, attached particular significance to this aspect of the first ruling, stating (191 F. 2d 831, 846):

²² In an article by J. P. Wenchell, "Taxpayers' Rulings" 5 Tax L. Rev. 105, 112, the author, a former Chief Counsel of the Bureau of Internal Revenue, stated that the Commissioner's action in the *Couzens* case "did little to instill public faith and confidence in the Bureau."

"Under the foregoing circumstances, and especially because of the fact that the Commissioner was given the unusual power by Congress to approve the plan and trusts and did so at various times during the course of the years, with full knowledge of all details relating to them and their operations, we are of the opinion that the Commissioner, in this case, was bound by the prior decisions of his predecessor that the plan complied with Section 165(a) of the Internal Revenue Code, as amended, and that the trusts were exempt."

The Commissioner, in determining in 1934 and 1938 that ~~that~~ petitioner was exempt from taxation, was performing precisely the same function he performed in determining that the trusts in the *H. S. D. Company* case were exempt from taxation. In both cases he made an administrative adjudication—he did not purport to render merely an advisory opinion.

The ruling letter of June 11, 1934 (R. 48) did not state that it was the current opinion of the Commissioner, subject to retroactive change, that petitioner was tax-exempt. The letter stated "It is held that you are entitled to exemption", and the letter referred to "The exemption granted in this letter." The lack in the letter of any suggestion or warning that the Commissioner might change his mind and revoke with retroactive effect is in striking contrast to the cautionary notice appearing on the front page of the Internal Revenue Bulletin for 1934, which states with respect to rulings published in the Bulletin:

"The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as *showing the trend of official opinion* in the administration of the Bureau of Internal Revenue." (Emphasis supplied.)

In writing the majority opinion for the court below Judge Allen attempted a distinction—which Judge Goodrich found was doubtful—between petitioner's case and the *H. S. D. Company* case. She stated (R. 190, 195) that the *H. S. D. Company* case involved no mistake of law but only different inferences from the same facts, and that "The Commissioner is not bound by his own or his predecessor's prior mistakes of law," but noted that in the *Kales* case the court declared that the Commissioner's "mistake of law will often, or usually, justify a revision of his conclusion." (Emphasis supplied.)

It is not necessary for petitioner to quarrel with the proposition, if it is stated as a general rule, that the Commissioner is not bound by his predecessor's mistakes.²³ Petitioner's case qualifies as a most proper exception to any such general rule. As Judge McAllister pointed out in his dissenting opinion, the Commissioner in 1934 and 1938, in ruling that petitioner was exempt from tax, did not make a mistake which was plainly erroneous or in conflict with express statutory provisions.

The first court decision as to the tax status of automobile clubs like petitioner was rendered on February 26, 1948 (more than two years after the Commissioner revoked pe-

²³ There is no question, of course, as to the right and propriety of correcting errors prospectively. But in the case of retroactivity, it is difficult to draw, insofar as equity is concerned, a distinction between a mistake of law and a mistake of judgment. If the Commissioner renders a ruling to a taxpayer, the Commissioner is bound by that ruling, under Judge Allen's view in opinion below, if the Commissioner correctly understood the law and correctly understood the facts, but make a mistake in putting the two together. But the Commissioner is not bound, according to Judge Allen, if he correctly understood the facts but made a mistake in the process of putting the law and facts together because of an erroneous interpretation of the statute. The distinction seems to be only one of words. In either case, the error was made by the Commissioner, and not by the taxpayer.

tioners' exemption) in the case of *California State Automobile Ass'n v. Smyth*, 77 Fed. Sup. 131 (Calif. D. C.). In this decision Judge Lemmon, now a member of the Court of Appeals of the Ninth Circuit, held that the automobile association was a club within the meaning of the statute. His decision, however, was reversed by the Ninth Circuit, *Smyth v. California State Automobile Association*, 175 F. 2d 752 (1949). When the same question was presented to the Tax Court in *Chattanooga Automobile Club v. Commissioner*, 12 T. C. 967, decided June 8, 1949, four members of that court were of the opinion that automobile clubs were exempt from taxation under section 101(9) of the Internal Revenue Code of 1939.

The Commissioner, of course, cannot contend that the meaning of the term "club" as used in section 101(9) was crystal clear. While he finally concluded that the term as used in the statute "contemplates commingling of members, one with the other in fellowship" (R. 67), he did not get that concept from a simple reading of a statute. His predecessor was unable to find that concept in the statute when he issued rulings in 1934 and 1938 to petitioner that it was exempt from taxation.

Against this picture Judge McAllister in his dissenting opinion stated (Record 200, 208):

"That the prior rulings of the other Commissioners were based on a mistake of law, and, consequently, that the rulings can be revoked with retroactive effect, is the keystone of the Commissioner's argument in this case.

"While the foregoing may be said to constitute the general rule, it is not every ruling based upon a mistake of law that may be afterward subject to so-called correction by the Commissioner, with retroactive effect. Where the construction of a statute by a former Commissioner has not been plainly er-

roneous, or in conflict with express statutory provision, a succeeding Commissioner may not revoke the former ruling with retroactive effect."

We submit that Judge McAllister was right.

The exemption letter of June 11, 1934 (R. 49) advised petitioner that it would not be required to file income tax returns "so long as there is no change in your organization, your purposes or methods of doing business." The exemption letter of July 5, 1938 (R. 59) stated: "the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed." The revocation letter of July 16, 1945 (R. 67), in requiring the petitioner to file returns for 1943 and 1944, was a repudiation not only of the previous rulings as to the filing of returns, but it was a repudiation of the Commissioner's regulations. The regulations in effect on March 15, 1944, the due date for filing a return for the calendar year 1943 provided:

"When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, *unless it changes the character of its organization or operations or the purpose for which it was originally created* * * *." (Emphasis supplied.) Section 29.101-1 of Regulations 111, prior to amendment by T. D. 5381, 1944 C. B. 188."

²⁴ On June 26, 1944, T. D. 5381 amended the regulations under section 101 to conform them to the provisions of section 54(f), (added to the Code by the Revenue Act of 1943), relating to the filing of returns by tax-exempt organizations on Form 990. The amended regulations, applicable to taxable years beginning after 1942, continued to instruct the petitioner that it need not file a return of its income (other than the return on Form 990) for its years 1943 and 1944, by stating: "An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54(f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the duty of filing other returns of information (see section 147 and 148)."

The regulations advising an organization that it need not file income tax returns after it has established its right to exemption are of long standing. They so provided in 1934 when the petitioner first established its right to exemption from taxation. Reg. 86, Art. 101-1. (Appendix A, page 4a.) These regulations, of course, were designed for the benefit and protection of the taxpayer and not for his entrapment. During a succession of revenue acts, Congress ratified and approved the regulations by its reenactment of the provisions of section 101 of the Internal Revenue Code of 1939. *Helvering v. R. J. Reynolds Tobacco Co.*, (1939) 306 U. S. 110.

The attempt in 1945 by the Commissioner to revoke with retroactive effect petitioner's exemption from filing returns was an attempt to deny petitioner the benefit of the regulations in force during 1943 and 1944. It is submitted that this attempt was a violation of a principle enunciated by this Court in the *Reynolds Tobacco* decision.

C. The Commissioner's Reliance on Section 3791(b).

Section 3791(b) of the Internal Revenue Code of 1939 provides as follows:

"Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulations, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

The Commissioner contends that this section makes it clear that in 1945 he had the power, if he wished to exercise it, to revoke retroactively the previous rulings issued to petitioner without restriction or limitation. He made a similar contention to this Court in the case of *Helvering v. R. J. Reynolds Tobacco Co.*, *supra*.

In the *Reynolds Tobacco* case, the taxpayer in 1929 sold treasury stock at a gain. The regulations then provided that a corporation realizes no gain or loss from the sale of its own stock. In 1934 the Commissioner amended his regulations to provide that taxable gain can be realized on the sale of treasury stock where the corporation deals in its own stock as it might in the shares of another company, and the Commissioner made the amended regulations effective retroactively to the year 1929. The Commissioner contended that section 3791(b) (then section 605 of the Revenue Act of 1928) specifically authorized such retroactive application. This Court disagreed and held, in effect, that there is no need to look at section 3791(b) until it is first determined that the Commissioner is confronted with a case in which retroactivity is permitted. This Court denied retroactive application of the amended regulations involved in the *Reynolds* case because of the reenactment by Congress, without change, of the definition of "gross income" while the old regulations were outstanding.

In this connection it is important to note that the Commissioner in 1934 did have the power to amend the regulations with prospective effect, although he did not have the right to do so retroactively. In *Dow Chemical v. Kavanagh* (6th Cir. 1943) 139 F. 2d 42, the taxpayer in 1936 (after the amendment in 1934 of the regulations involved in the *Reynolds Tobacco* case) sold treasury stock at a gain. The taxpayer contended that the regulations were invalid, but the Sixth Circuit held that the amended regulations were valid when applied with prospective effect only. The Court said:

"It will be noted that there is here no question of giving retroactive application to the amended regulation so as to make taxable transactions which were not taxable before it was promulgated, as was the case in *Helvering v. R. J. Reynolds*. * * * If, however, there is an implication in the argument used in

the *Reynolds* case that an amended regulation is to be considered effective only after congress has re-enacted the provision sought to be interpreted, without change, the inference is definitely destroyed by the more recent cases of *Helvering v. Wilshire Oil Co.*, 308 U. S. 90 and *Helvering v. Reynolds*, 313 U. S. 428."

In *United States v. Anderson, Clayton & Co.* (1955), 350 U. S. 55, the Commissioner's 1934 regulations on gain from a sale (made in 1944) of treasury stock was again before this Court. The Court, at page 59, stated the question as follows: "Thus, whether the transaction here in question is taxable depends, in the final analysis, on whether respondent corporation dealt with its shares of treasury stock 'as it might' have dealt with another corporation's stock." No suggestion was made by the Court that the application, with prospective effect, of the amended regulations adopted in 1934 was invalid by reason of its prior decision in the *Reynolds Tobacco* case, *supra*.

We learn from the foregoing cases that although the Commissioner in 1934 had the right to amend his regulations with prospective effect, it did not follow from section 3791(b) that he therefore had the right to make the amendment applicable with retroactive effect. The Commissioner's rule-making power, insofar as prospective application is concerned, is not a measure or indication of his rule-making power with retroactive application.²⁵

²⁵ "It [legislative approval] does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers. * * *

"These considerations are persuasive here not only in reaffirming the conclusion that the rule-making power existed, but also in concluding that restrictions on that power should not be lightly imposed where the incidence of such rules as are promulgated is prospective only." (Emphasis supplied.) *Helvering v. Wilshire Oil Co.* (1939) 308 U. S. 90, 100, 103.

Dean Griswold, in his article "A Summary of the Regulations Problem", 54 *Harv. Law Rev.* 398, points out that the Commissioner should be *held* to have no power to make retroactive amendments of interpretive regulations, against the interests of taxpayers, in any case where the regulation has become seasoned, without regard to the reenactment rule. Insofar as section 3791(b) might be viewed as an obstacle to getting the right result, he observed at page 412:

"The legislative history of this is interesting and mildly illuminating in showing the Treasury's struggle to get away from the judicial-decision theory of interpretive regulations. See *Seidman, Legislative History of Federal Income Tax Laws* (1938) 886-88, 563-64, 408-409. This statute did not greatly hinder the Court in *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 116 (1939), and it would seem that similarly it should not be a serious obstacle to the treatment of retroactive changes proposed here."

Section 3791(b) should be interpreted and applied in accordance with the purpose which Congress had in enacting the original provision. The legislative history referred to by Dean Griswold makes it perfectly apparent that the purpose was to *prevent* retroactivity—not to codify or confirm any right in the Commissioner to take retroactive action. The report of the Conference Committee (70th Cong. 1st Sess., H. Rept. 1882) on the Revenue Act of 1928 stated (at page 22):

"It is hoped that this provision [the predecessor provision of section 3791(b)] will *prevent* the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and *burden of interpreting the law* and of prescribing regulations upon which the *taxpayers may rely* * * *." (Emphasis supplied.)

Petitioner need not—and does not—contend that the Commissioner can never revoke an individualized ruling with retroactive effect. To state an easy case, even where a ruling of tax exemption is involved, petitioner readily concedes that if such a ruling is based on a misrepresentation of facts by the taxpayer, the Commissioner has the power to revoke with retroactive effect²⁸. But if the misrepresentation was not willful, the Commissioner should have—and does have under section 3791(b)—the right to temper the amount of retroactivity.

But it is quite another matter to hold that the Commissioner also has power under section 3791(b) to revoke, with retroactive effect, a prior determination of the kind presented in petitioner's case. When a taxpayer, under the mandate of the Commissioner's regulations under section 101, submits in good faith, without reservation or misrepresentation of any fact or circumstance, all the information requested by the regulations, and the Commissioner makes an administrative adjudication that the taxpayer is exempt from taxation and from filing income tax returns, and thereafter the organization operates without change in the manner contemplated by the Commissioner, the Commissioner should be held not to have power to re-

²⁸ Southern Maryland Agricultural Fair Association (1939) 40 B. T. A. 549, was a case in which the taxpayer misrepresented the facts on which the Commissioner made his ruling of tax exemption, and the retroactive revocation of the ruling was upheld. The Tax Court, in petitioner's case below, rested its decision (R. 144, 153) on the Southern Maryland case in holding that the Commissioner had the right to revoke retroactively petitioner's tax-exempt status.

voke his determination with retroactive effect.²⁷ This should be the result whether the erroneous ruling originally granted was due to the Commissioner's misinterpretation of the statute or to an error in passing judgment as to the effect of undisputed facts and law.

Petitioner's case is even stronger than the proposition stated in the preceding paragraph. Petitioner's rulings of tax exemption had been outstanding for a long period of years; and it cannot be said that any misinterpretation of section 101(9), by the Commissioner granting the rulings, was plainly erroneous or in conflict with the express provisions of the statute.

The correct result in petitioner's case can be reached by a slightly different approach. Instead of stating that section 3791(b) was inapplicable in petitioner's case, it need merely be stated that any attempt to make the revocation of the rulings applicable to years prior to the year in which the revocation was made was, under the facts of

²⁷ In *R. H. Stearns Co. v. United States* (1934) 291 U. S. 54, Mr. Justice Cardozo observed (at pp. 61-62):

The applicable principle is fundamental and unquestioned. "He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned, for the law says to him, in effect: 'This is your own act, and therefore you are not damnified' " * * * Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon its own iniquity or take advantage of his own wrong. * * * A suit may not be built on an omission induced by him who sues. * * *

petitioner's case, arbitrary and an abuse of discretion.²⁸ Petitioner has conceded that the revocation on July 16, 1945, of its tax-exempt status, applied to the entire calendar year 1945. To that extent, the revocation was applied retroactively for a period of about six and one-half months, but petitioner would not claim—if section 3791(b) were applicable—that it was arbitrary and an abuse of discretion to make the 1945 ruling applicable to the taxable year in which received. But petitioner would contend and insist, if section 3791(b) were applicable, that under the facts of petitioner's case the Commissioner was arbitrary and abused his discretion under section 3791(b) in making the 1945 ruling effective to any taxable year already passed.

Congress has made it clear that it believes it is wrong to revoke a tax exemption with retroactive effect, except where the organization has been guilty of gross misconduct. When Congress dealt with the problem, it provided that if the Commissioner notifies an organization that it has lost its exemption by reason of engaging in prohibited transactions, the loss of exemption will apply only for taxable years *subsequent* to the year in which the Commissioner gives such notice. Section 3813 of the Internal Revenue Code of 1939 (now section 504 of the 1954 Code) was added to the 1939 Code by section 331 of the Revenue Act of 1950. Congress then provided that certain organizations exempt from taxation under section 101(6) of the 1939 Code would lose their exemption on engaging in certain pro-

²⁸ This was the approach used by Judge Goodrich in the Lesavoy Foundation case, *supra*, in holding that the retroactive revocation of tax exemption was invalid. But Judge McAllister, dissenting below, in holding that the retroactive revocation in petitioner's case was invalid stated that section 3791(b) "would not seem to apply when the Commissioner does not have the power to make a retroactive ruling" (R. 217).

hibited transactions. But as to the effective date of the loss of tax exemption, section 3813(c)(2) provides:

“(2). Taxable years affected.—An organization shall be denied exemption from taxation under section 101(6) by reason of paragraph (1) *only for taxable years subsequent to the taxable year during which it is notified by the Secretary that it has engaged in a prohibited transaction*, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.” (Emphasis supplied.)

Retroactivity is not favored in the law.²⁹ When we compare the policy contained in section 3813 against retroactive loss of a tax exemption (even when the taxpayer is at fault) with the action taken by the Commissioner in petitioner's case (where a Commissioner, and not the petitioner, miscued), it is quite obvious that it is not safe to rely on the Commissioner's sense of fairness with respect to retroactivity. Unfortunately, court-imposed restraints have become necessary.

D. Reliance by Petitioner on the Rulings of Tax Exemption.

In the majority opinion for the Court below, Judge Allen stated (R. 190, 194): “As to the question of estoppel, petitioner does not assert that it has altered its position to its detriment in reliance on the former rulings of Com-

²⁹ “Retroactivity, even when permissible, is not favored, except upon the clearest mandate. It is the normal and usual function of legislation to discriminate between closed transactions and future ones. * * *” (Emphasis added.) Claridge Apts. v. Commissioner of Internal Revenue, 323 U. S. 141, 164.

missioner."³⁰ In its brief to the Court below, petitioner made the following assertions:

"The petitioner relied in good faith on the rulings made by the Commissioner in 1934 and 1938 holding it exempt from taxation. In keeping with the instructions received in the ruling letters, petitioner did not file income tax returns, since no change had occurred in the organization of the club, its purposes, or activities. Petitioner, in faithful reliance on the tax-exempt rulings, did not during 1943 and 1944 set up any reserve, or make any other provision, to cover the income and excess profits taxes later asserted by the Commissioner for those years. The club was operated during 1943 and 1944 in all respects on the premise that it was exempt from taxation. As a result of the retroactive application of his 1945 ruling, the Commissioner asserted a deficiency in income and excess profits taxes for the years 1943 and 1944 in the amount of \$384,059.97."

Judge McAllister, in his dissenting opinion below, had no difficulty in finding that petitioner had relied on the rulings to its detriment (R. 218).

The Commissioner contends in this case that even though a taxpayer has a ruling stating that he is exempt from tax and from filing income tax returns, the statute of limita-

³⁰ In a Note, 56 Columbia Law Review 1115, commenting on the majority opinion below, it was stated (at page 1118): "It seems rather evident that the Commissioner's prior rulings did in fact induce reliance by the taxpayer to its detriment, in that no provision was made to attempt to meet the tax assessment, nor was a return filed to start the running of the statute of limitations. * * * Although taxpayers might protect themselves to some extent by filing returns whether an exemption is granted or not, it would seem that when taxpayers reasonably rely on rulings specially made for their own given set of circumstances, it is not out of order to prevent the Government, either by legislative provision or court-imposed estoppel, from subsequently upsetting these justifiable expectations."

tions can nevertheless not commence to run until a return is filed. If the Commissioner is correct in that contention, then it is hardly necessary to comment further. Certainly reliance on a ruling at the expense of losing the protection of the statute of limitations constitutes reliance with unmistakable detriment.

The petitioner kept its books and managed its affairs on the assumption that it was exempt from taxation. One of the officers of petitioner testified (R. 138): "We weren't taxable. We didn't have that problem to consider." Certainly it is a matter of common knowledge, requiring no additional support in the record, that a taxable organization cannot intelligently engage in business from day to day without taking into account the tax consequences of contemplated transactions. This was particularly true during 1943 and 1944 when the excess profits tax rate of 90% was applicable. (A part of the asserted deficiencies for 1943 and 1944 was attributable to the excess profits tax.) Prior to the revocation of its tax exemption, petitioner conducted its affairs as if income and excess profits taxes did not exist. Moreover, if it had anticipated prior to 1945 that it would be subjected to taxation for prior periods, reserves for such taxes would have been established.

It is not an answer to assert that a taxpayer does not suffer a detriment if he is unexpectedly called upon to pay taxes which were imposed on him but which he believed, by reason of a tax-exempt ruling, were not payable by him. The detriment would be ridiculously obvious if the petitioner in 1945 had been called upon to pay taxes for all years from 1916 to 1945. No doubt its assets would have been insufficient. Any lesser amount of retroactivity merely reduces, but does not eliminate, the degree of detriment. In the *Lesavoy Foundation* case, *supra*, there was no dispute as to the amount of taxes imposed for the

prior years if the Commissioner had the right to revoke retroactively the tax exemption. There was no element of reliance with detriment in the *Lesavoy* case which is not present in petitioner's case.

E. Petitioner Did Not Receive Notice of Revocation Before July 16, 1945.

The Commissioner has contended that its revocation of petitioner's tax exemption was really not a retroactive revocation in light of the publication in the Internal Revenue Bulletin of *G. C. M. 23688*, 1943 C. B. 283. Neither the Tax Court nor the Circuit Court of Appeals adopted the Commissioner's position on that score. Both courts rested their decisions on the ground that the Commissioner had the power in 1945 to revoke retroactively the prior rulings. Judge McAllister, in his dissenting opinion below, specifically held (R. 216):

"The taxpayer did not have notice as claimed herein by the Commissioner, during 1943 and 1944, of the pending revocation of its exemption rulings."

He pointed out that the *G. C. M.* concerned the American Automobile Association, an organization consisting of other incorporated clubs and having rules against membership of any individuals. On this point, it is pertinent to note the characterization given to *G. C. M. 23688* in the opinions in *Chattanooga Automobile Club*, 12 T. C. 967 (1949). The majority opinion, by Judge Murdock, held that the automobile club was taxable because it was rendering services of a commercial nature to members. He made no mention of *G. C. M. 23688*. In a dissenting opinion, Judge Harlan stated (p. 972):

"Recently, however, General Counsel Memorandum 23688, 1943 C. B. 283, was promulgated, and

therein the General Counsel ruled differently concerning an automobile 'association'. The proceeding at bar is an attempt to support this memorandum on the apparent assumption that it applies to local automobile 'clubs'." (Emphasis supplied.)

Judge LeMire, in a separate dissenting opinion, stated with respect to the G. C. M. (at p. 973):

"* * * It was not until 1943 that he reversed his position, ruling in G.C.M. 23688, 1943 C. B. 283, that an association functioning as a federation of automobile clubs was not a club within the meaning of section 101(9), Internal Revenue Code, and was not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of that section." (Emphasis supplied.)

Most important is the fact that the Commissioner himself did not, until this case reached litigation, consider that petitioner had received notice in 1943 of the revocation of its tax exempt status. The letter which the Commissioner sent to petitioner on May 12, 1945 (R. 59, 60) stated that the "Bureau is now reconsidering" the question of the exemption of automobile associations in the light of the opinion of the Chief Counsel as set forth in G. C. M. 23688. Furthermore, the Commissioner did not claim or assert in this proceeding that the petitioner was subject to any penalty for failure to file the returns for the years 1943 and 1944 within the time prescribed by law. The failure to assert any penalty is, of course, consistent with the simple fact that the Commissioner himself did not consider the publication of G. C. M. 23688 as notice to the petitioner that its tax exempt status had been revoked.

It might be also added that a General Counsel Memorandum is not a notice or a ruling to taxpayers, but is merely an opinion from the General Counsel to the Commissioner

for his consideration. As stated in *Van Dyck v. Commissioner*, (9th Cir., 1941) 120 F. 2d 945: " * * * they [G. C. M.s] were merely communications from counsel to the Commissioner. The advice they contained was for the Commissioner's, not petitioner's, guidance."

While the Commissioner may generally follow the legal advice received from his counsel, it would not have been surprising if, in this instance, he had decided not to apply the ruling to automobile clubs having individual members, as in the case of petitioner, in view of his long standing position that such clubs were exempt from taxation.³¹

III.

THE STATUTE OF LIMITATIONS

A. The Statute of Limitations Started to Run on Due Date for Return.

It is submitted that the statute of limitations started to run, in the case of the year 1943, on March 15, 1944, the due date for the return for that year, and, similarly, in the case of the year 1944, on March 15, 1945, even though returns were not actually filed on those dates.

Under section 275(a) of the Internal Revenue Code of 1939 (Appendix A, p. 3a), the three-year statute of limitations commences to run from the date the return is filed. However, the courts have held that where a taxpayer is not under a duty to file a return, the three-year statute of

³¹ In the *Chattanooga Automobile Club* case, 12 T. C. 976, four judges, dissenting, held that the long administrative practice with respect to the exemption of automobile clubs was such that any correction should be by Congressional action, and not by judicial decision.

limitations starts running from the date the returns should have been filed if there had been a duty to file it: *Balkan Nat. Ins. Co. v. Commissioner of Internal Revenue*, (2nd Cir., 1939) 101 F. 2d 75, *Stockstrom v. Commissioner of Internal Revenue*, (App. D. C. 1950) 190 F. 2d 283.³²

In the *Balkan Nat. Ins. Co.* case, the Commissioner mailed a notice of deficiency in 1934 with respect to the income and profits tax liabilities for the year 1918. The taxpayer, a foreign corporation, had not filed a return for the year 1918, and the Commissioner relied upon the provision of the statute which stated that the amount of the tax may be assessed at any time in case of a failure to file a return. The taxpayer had not filed a return for 1918 for the reason that in January of 1919 all of the taxpayer's assets, including its books of account and records, were seized by the Alien Property Custodian. The taxpayer claimed that the statute of limitations commenced to run on the due date for the filing of its return for the year 1918, contending it was excused from filing a return by reason of the seizure by the Alien Property Custodian of its books and records. The Second Circuit held that the statute of limitations started to run on March 15, 1919, under the circumstances of the case, for the following reasons:

"While literally there has been a 'failure to file a return,' that phrase as used in section 278(a) cannot reasonably be interpreted to include a failure caused by the Government itself through seizure of the taxpayer's records. The obvious purpose of this section was to give the revenue officials unlimited

³² Both Judge McAllister, in his dissenting opinion below, and Judge Goodrich, in his opinion in the *Lesavoy* case, *supra*, relied on the *Stockstrom* case in holding that the Commissioner was without authority to revoke retroactively the rulings of tax exemption.

time to assess and collect taxes in cases where the necessary data for determining the amount of the tax was lacking *because of the taxpayer's fault in failing to supply it in the form of a return.* . . .

In *Stearns Co. v. United States*, 291 U. S. 54, 62, 54 S. Ct. 325, 78 L. Ed. 647, the Supreme Court approved the principle that 'A suit may not be built on an omission induced by him who sues.' There the principle was applied to prevent a taxpayer from relying on the statute of limitations. We believe it is equally applicable to prevent the United States from avoiding the statute."

In the case of *Stockstrom v. Commissioner of Internal Revenue*, *supra*, the taxpayer had made gifts in trust during the calendar year 1938, and, after consulting with the head of the Federal Estate and Gift Tax Section of the Office of the Bureau of Internal Revenue in St. Louis, did not file a gift tax return for that year for the reason that the Bureau officials advised him that no tax or return was due. Stockstrom had not been correctly advised by the Bureau officials as to the law—he had, in law, made taxable gifts in 1938. In 1948 the Commissioner issued a 90-day letter with respect to the gift tax liability for the calendar year 1938, claiming that the statute of limitations had not run since no return had been filed. The United States Court of Appeals for the District of Columbia Circuit held that the statute of limitations commenced to run on the due date for the return for the year 1938, notwithstanding that the statute provided that upon a failure to file a return the tax may be assessed at any time. In this case the Court cited the decision of the Second Circuit in *Balkan Nat. Ins. Co.*, *supra*, and said at pages 288, 289:

"Stockstrom did not physically file a return for 1938, as we have seen. The question is, however, did he fail to file a return within the meaning of the limiting statute? Or, to put it another way, may the

Commissioner in the circumstances of this case rely upon the failure to physically file a return as destroying the period of limitation? * * * *It has already been made to appear that Stockstrom's failure to file a return for 1938 was due to the Commissioner's ruling, made in 1938 and reaffirmed as late as 1941, that none was required of him. The Commissioner therefore induced the omission which he now relies upon as giving him unlimited time within which to assess a tax. * * ** We conclude that Stockstrom's failure to file a return for 1938 was not the sort of failure contemplated by Par. 1016 of the Internal Revenue Code. * * * It has been well said that the government should always be a gentleman. Taxpayers expect and are entitled to receive, ordinary fair play from tax officials. *We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure.*" (Emphasis supplied.)

Petitioner finds itself in the same position as the taxpayer in the *Balkan Nat. Ins. Co.* case and the *Stockstrom* case. Petitioner did not file income and excess profits tax returns on the due dates for the years 1943 and 1944 for the reason that the Bureau had previously issued two rulings advising it that it was exempt from taxation and need not file returns so long as the character and nature of its organization and operation remained unchanged. There had been no change which placed the petitioner under a duty to file returns. The failure to file returns on the due dates was induced by the Commissioner—petitioner was entirely blameless.

It should be noted that the revocation letter of July 16, 1945 (R. 66, 67) recognized that petitioner on March 15, 1944 and on March 15, 1945 was not required to file income tax returns for the years 1943 and 1944, respectively.

The letter stated "you *will*" not be required to file returns for years prior to 1943—it did not say you *were* required to file, but you need not now do so. The letter stated "you are" required to file returns for 1943 and subsequent years—it did not state you *were* required to file returns for 1943 and 1944.

It follows that since petitioner was not under a duty to file returns on March 15, 1944 and March 15, 1945, the statute of limitations provided for in section 275(a) commenced to run on those dates. Petitioner's failure to file a return was not, as the above cases hold, a failure to file within the meaning of section 276(a) of the Internal Revenue Code of 1939 (Appendix A, p. 3a).

On August 25, 1948 petitioner did execute waivers extending the period of time for assessment of the tax for the years 1943 and 1944. But since these waivers were not executed until after the expiration of the three-year statute of limitations prescribed in section 275(a) I. R. C. the waivers were, under the provisions of section 276(b) of the Internal Revenue Code of 1939 (Appendix A, p. 3a), without legal effect.

B. Form 990 Constituted a Return for Purposes of the Statute of Limitations.

While petitioner was excused under the ruling letters of tax exemption, and under the regulations, from filing the regular income and excess profits tax return form for the years 1943 and 1944, the petitioner was required to file a return of its income on Internal Revenue Form 990, under the provisions of Section 54(f) of the code (Appendix A, p. 2a).

Petitioner filed on Form 990 a return of its gross income, receipts, and disbursements for the calendar year

1943 on August 12, 1944, and for the calendar year 1944 on May 17, 1945 (R. 20).

In the ordinary situation, it is the filing by a corporation of the return required by section 52 of the code which starts the running of the statute of limitations provided for in section 275(a) (Appendix A, p. 3a). (The provisions of sections 52 and 275 were made applicable by section 729 of the Code with respect to returns of the excess profits tax imposed during World War II.) However, this Court has held that the statute of limitations can start to run even though the corporation does not file its return pursuant to the provisions of section 52.

In the case of *Germantown Trust Company v. Commissioner of Internal Revenue* (1940), 309 U. S. 304, the taxpayer was a trust company and was taxable as a corporation. Instead of filing a corporate return on Form 1120, as required by section 52 of the Revenue Act of 1932, it filed pursuant to section 142 of that Act a fiduciary return on Form 1041, which is a return for fiduciaries taxable at the individual tax rates. This Court held, even though no corporate return had been made, that the return made on the fiduciary return form constituted a return for the purposes of the statute of limitations under section 275(a) of that Act.³³

Similarly, the return on Form 990 filed pursuant to section 54(f) should be deemed a return for the purpose of the statute of limitations under section 275(a). Section

³³ In *Commissioner v. Lane-Wells Co.* (1944) 321 U. S. 219, this Court held that the filing of the regular corporation income tax return did not start the running of the statute of limitations against the surtax imposed on a personal holding company. But the corporation income tax return filed did not disclose facts from which the Commissioner could determine whether or not the corporation was a personal holding company. That type of issue is not presented by petitioner's case.

52 provides that every corporation subject to tax "shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe." (Appendix A, p. 1a.)

In the case of an organization claiming exemption from tax under section 101, section 54(f) requires the filing of "an annual return . . . stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe." (Appendix A, p. 2a.)

Thus, we have the two sections 52 and 54(f), both in part V of subchapter B of chapter 1 of the Internal Revenue Code of 1939, requiring in almost identical language the filing of returns containing substantially the same information—one section applying to corporations subject to tax and the other to exempt organizations. In view of the decision of this Court in the *Germantown Trust* case, *supra*, it should follow that a return filed pursuant to section 54(f) will qualify as a return for the purpose of section 275(a).³⁴

³⁴ In *Danz Charitable Trust v. Commissioner* (9 Cir., 1955) 231 F. 2d 673, cert. denied Oct. 8, 1956, — U. S. —, it was held that the filing of Form 990 did not start the running of the statute of limitations. But it can be noted that in the *Danz* case the Commissioner had not previously ruled that *Danz* was exempt from taxation. Since *Danz*, unlike petitioner, had not previously established its right to exemption, it was not entitled under the regulations to rely on the provision that a return on Form 1120 need not be filed. *Danz* took the risk that Form 990 was the required return to be filed. Petitioner, in filing Form 990, filed the only return it was required to file under the regulations and rulings issued to it.

It appears that there has been in effect for some years an unpublished ruling of the Bureau of Internal Revenue holding that returns on Form 990 can commence the running of the statute of limitations. An official Government publication advised farmers' cooperatives as to the effect of filing a Form 990. The United States Department of Agriculture, in Miscellaneous Report No. 106 of the Farm Credit Administration, dated April 1947 and bearing the title "Preparing Federal Annual Returns for Tax Exempt Farmers' Cooperatives" advised as follows (p. 4):

"In the case of taxable businesses, the Federal limitations statute bars the Government from making an assessment of taxes after expiration of 3 years from the date of filing an income tax return, except where the latter is fraudulently made.

"While an official ruling has not been published by the Bureau of Internal Revenue, it is understood informally that the 3-year period of limitations is started in the case of tax-exempt organizations upon their filing of Form 990 provided, of course, that the return is full and complete."

Since the waiver agreements of August 25, 1948 were executed by petitioner more than three years after the filing of the returns on Form 990 for the years 1943 and 1944, the waivers were not effective to extend the statutory period of limitations provided in section 275(a).

Inasmuch as the returns filed on Form 990 for 1943 and 1944 constituted the returns for those years, the subsequent filings on October 22, 1945 of additional returns, pursuant to the Commissioner's request in his letter of July 16, 1945, are without legal significance. Those returns were filed under protest, and with no tax shown on the return. If a return is filed for a taxable year, a new or amended return subsequently filed after the due date does not start anew the running of the statute of limita-

tions. *Northern Anthracite Coal Co.*, (1931) 21 B. T. A. 1116, *Ira Goldring*, (1953) 20 T. C. 79.

In filing the Forms 990 the petitioner furnished all of the information as to its income and expenses requested by the forms. Since the Commissioner had advised the petitioner not to file a taxable return, the Commissioner is hardly in a position to allege that the information he requested on Form 990, and which was fully and completely furnished, was insufficient.

It can fairly be asked, what more is required of a taxpayer than to comply with the regulations and written instructions received from the Commissioner? Since the Commissioner informed petitioner to file only Form 990, the Commissioner should not now assert that the return so filed did not constitute a return for the year.

C. Significance of the Statute of Limitations in the Case of Tax Exempt Rulings.

In the ordinary case, a ruling which the taxpayer receives from the Commissioner does not advise him to abstain from filing income tax returns. But when the Commissioner rules that an organization is exempt from tax, the ruling (and regulations) will advise the organization—as petitioner was advised—that it should not file income tax returns so long as there is no change in its purposes or method of doing business.

In seeking an answer to the question of whether the Commissioner has the power to revoke retroactively a tax exempt ruling, there is a very practical relationship between that question and the question as to the statute of limitations. If the answer is that the statute of limitations cannot run when a taxpayer fails to file a return in reliance on a tax exempt ruling, such an answer presents a special reason and need for holding that the Commissioner

does not have the power to revoke retroactively. On the other hand if the rule is that the Commissioner does have the power to revoke retroactively, it becomes imperative to find some protection for the taxpayer under the statute of limitations.

Certainly there must be some bounds to the extent to which the Commissioner can entrap a taxpayer by issuing a ruling of tax exempt status on which the taxpayer relies in good faith. If the Commissioner under the law has the right to revoke a ruling of tax exempt status with retroactive effect, every-day considerations of equity and fair play call for the application against the Commissioner of the rule of the *Balkan* and *Stockstrom* case, *supra*, that the statute of limitations commences to run on the due date for the filing of the return for the taxable year where the omission to file was induced by the Commissioner.

CONCLUSION

It is urged that for the foregoing reasons the judgment of the Court below should be reversed with instructions to expunge the deficiencies found below for the years 1943 and 1944 and to compute petitioner's income from membership dues in accordance with the method of accounting employed by the petitioner.

Respectfully submitted,

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Dated: January 21, 1957.

APPENDIX A

STATUTES AND REGULATIONS

INTERNAL REVENUE CODE OF 1939, AS AMENDED

Sec. 41. General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

Sec. 42. Period in Which Items of Gross Income Included.

(a) General Rule.—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

Sec. 52. Corporation returns.

(a) Requirement.—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information

for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. * * *

Sec. 54. Records and Special Returns.

* * * * *

(f) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *

[Section 54 (f) added to the Internal Revenue Code by section 117(a) of the Revenue Act of 1943 and is applicable to taxable years beginning after December 31, 1942.]

Sec. 101. Exemptions from Tax on Corporations.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in section 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Sec. 276. Same—Exceptions.

(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) Waiver.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreement in writing made before the expiration of the period previously agreed upon.

Sec. 3791: Rules and Regulations.

(b) Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the

Secretary, may prescribe the extent, if any, to which any ruling, regulations, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

REGULATIONS 86

(Under the Revenue Act of 1934)

Art. 101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation.

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of, the affidavit referred to above:

.

(7) Clubs: The income received from the use of the facilities by the general public.

.

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

REGULATIONS 94

(Under the Revenue Act of 1936)

Art. 101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the

charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. Although religious or apostolic associations or corporations exempt under section 101(18) are relieved from paying the tax, they are required to file returns of income (see article 101(18)-1).

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to; and made a part of the affidavit referred to above:

(7) Clubs: The income received from the use of the facilities by the general public;

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. But see article 101(18)-1 with respect to religious or apostolic associations or corporations. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

REGULATIONS 111**(Under the Internal Revenue Code of 1939)****Sec. 29.41-1. Computation of Net Income.**

Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise, properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-3. Method of Accounting.

It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so.

Sec. 29.101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption under section 101 (6), Form 1023; under section 101 (1), (3), (7), or (8), Form 1024; under section 101 (9), Form 1025; under section 101 (10), (14) or (16), Form 1026; under section 101 (4), except bona fide credit unions, Form 1027; and under section 101 (12), Form 1028. All other organizations claiming exemption, including bona fide credit unions, shall file an affidavit showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation; provided, however, that such return shall not be required of an organization which is organized and operated exclusively for educational purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of an organization privately owned or operated, the Commissioner is advised of any increase in the compensation of its owners, managers, trustees, or directors over the amount of such compensation for the last year for which its exemption under section 101 (6) was approved by the Commissioner. Form 990 will not be required of charitable organizations operated or controlled by religious or educational organizations of the type exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof.

.

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and

when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization; * * * The return of information on Form 990 shall be filed on or before the 15th day of the fifth month following the close of the taxable year. When a mutual insurance company has established its right to exemption under section 101 (11) of the Internal Revenue Code or a corresponding provision of a prior income tax law it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or unless the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) exceeds \$75,000. * * *

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148)..

APPENDIX B

REVENUE RULINGS

Rev. Rule 54-164; 1954-1 C. B. 88:

"Existing procedures clarified and certain new procedures prescribed with respect to certain organizations claiming exemption, from Federal income tax, under section 101 of the Internal Revenue Code."

...

Sec. 6. Review and Conferences:

".01 The National Office shall conduct such review of determination letters issued by District Directors' offices (including tentative determination letters) as is considered necessary to assure conformity with the interpretations and policies of the Revenue Service. It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment. Any ruling issued as to the exempt status of an organization will not be considered controlling where there has been a

misstatement or omission of a material fact or where the operations of the organization are conducted in a manner materially different from that represented. A revocation may be effected by a notice to the organization or by a ruling or other statement published in the Internal Revenue Bulletin applicable to the type of organization involved. The same policy will be applicable to determination letters issued by District Directors."

...

Rev. Rul. 54-172; 1954-1 CB 394:

"Outline of the authority and general procedures of the National Office of the Internal Revenue Service and of the offices of the District Directors with respect to issuing rulings and determination letters to taxpayers and entering into closing agreements on specific issues.

...

Sec. 12. Effect of Rulings:

...

"105 A ruling found to be in error or no longer in accord with the position of the Internal Revenue Service may be modified or revoked. Modification or revocation may be effected by a notice to the taxpayer to whom the ruling originally was issued, or by a ruling or other statement published in the Internal Revenue Bulletin. However, it is the general policy of the Internal Revenue Service to limit the revocation or modification of a ruling issued to or with respect to a particular taxpayer to a prospective application only, (a) if there has been no misstatement or omission of material facts, (b) the facts subsequently developed are not materially different from the facts on which the ruling was based, (c) there has been no change in the

applicable law, and (d) such taxpayer acted in good faith in reliance upon such ruling and a retroactive revocation would be to his detriment.

“.06 With respect to rulings published in the Internal Revenue Bulletin, it is the general policy of the Service that taxpayers may rely upon such rulings in determining the rule applicable to their own transactions and need not request a specific ruling applying the principles of the published ruling to the facts of the taxpayer's particular case where otherwise applicable. See, however, .08 of this section. In the event of revocation or modification of a ruling published in the Internal Revenue Bulletin, it is the general practice of the Service to make such revocation or modification prospective only.”

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

**On Writ of Certiorari to the United States Court of Appeals
for the Sixth Circuit**

REPLY BRIEF FOR THE PETITIONER

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

**On Writ of Certiorari to the United States Court of Appeals
for the Sixth Circuit**

REPLY BRIEF FOR THE PETITIONER

THE ISSUE OF RETROACTIVE REVOCATION:

A. The Commissioner's Attack on His Regulations

It is clear from respondent's argument (Br. 21, 37) that the Commissioner makes no distinction, as petitioner asserted in its opening brief (p. 48), between a retroactive revocation of an individualized ruling of tax-exempt status—which an organization is required to apply for under the regulations—and a retroactive

¹ Petitioner will reply to the Commissioner's argument in the order in which the issues were discussed in the Commissioner's brief before this Court.

reversal of an interpretative ruling published in the Internal Revenue Bulletin, which some taxpayer may have read and relied upon.

The respondent's argument (Br. 21-24) evinces little or no respect for the regulations under section 101, on which petitioner has relied, even though it is customary for the Commissioner (at least when not in litigation) to urge taxpayers to obey and respect the regulations. While suggesting² (but not quite urging) that his regulations are invalid, the Commissioner certainly contends that his regulations should not be taken seriously, even by a taxpayer who has obeyed them and relied upon them.

While the regulations under section 101 (discussed and set forth in petitioner's brief commencing at page 44) most clearly provide that every organization claiming an exemption from tax is required to submit an application to the Commissioner for a ruling as to its tax-exempt status, and even though the regulations provide that when an organization has established its right to exemption it need not thereafter file income tax returns absent a change in the character of its organization or operations, the respondent contends (Br. 24): "These Regulations did no more than provide what kind of showing would be required to convince the Commissioner that the particular statutory provisions invoked by taxpayer were applicable."

² In disparaging his regulations, the Commissioner (Br. 27) referred to *Langstaff v. Lucas*, 9 F. 2d 691, 693 (W.D. Ky.), in which the District Judge stated that any erroneous interpretation of the law by Treasury Regulations could not estop the Government from asserting a tax even though the taxpayer may have been misled by the regulations. That case was decided before the decision of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U.S. 110.

Although the regulations provided that the information required of the taxpayer under the regulations would be submitted "to the Commissioner for decision as to whether the organization is exempt", respondent's brief (p. 27) states that the decisions made by the Commissioner in 1934 and 1938 as to petitioner's tax-exempt status "did no more than advise taxpayer that in the Commissioner's opinion, on the basis of the data submitted, the particular statutory provisions invoked by taxpayer did app'y, and that, barring a change of circumstances, the Commissioner would not require additional data to convince him."³

In his attempt to belittle the regulations, respondent's brief (p. 26) quoted (but insufficiently) from the opinion of the Board of Tax Appeals in *Savings Feature of Relief Dept. of B. & O. R.R. Co.*, 32 B.T.A. 295. But the Board did not in that case, as suggested by respondent, hold that taxpayers need not or should not comply with the regulations under section 101. The Court stated: (at page 306)

³ In an endeavor to exonerate himself, the Commissioner complains (Br. 41) that petitioner was the "moving party in the matter", and that petitioner "prepared and submitted evidence to the Commissioner in order to induce him (as it did) to issue the rulings in its favor". While it is hardly becoming for the Commissioner to blame petitioner for complying with the regulations, it can be pointed out that the petitioner was not the "moving party" with respect to the tax-exempt ruling given to petitioner on July 5, 1938. Although there had been no change of circumstances after the Commissioner in 1934 determined that petitioner was exempt from tax, the Commissioner on September 29, 1937, on his own initiative, requested petitioner to resubmit the proof of exemption called for under the regulations, and upon compliance by petitioner the Commissioner determined again (on July 5, 1938) that petitioner was exempt from filing returns. (R. 51, 59).

"The question of whether the Commissioner had the right to make the filing of proof of exemption a condition precedent to the right of exemption, need not be decided in this case. Even if the words of article 511 are to be interpreted as making the filing of proof of exemption a condition precedent to the right of exemption, still decision in this case must be for the petitioner. The petitioner, in March 1923 gave the Commissioner certain proof of its exempt character which complied at least in part with the regulations. Thereafter, more than eight years elapsed before the Commissioner made any move to assess a tax against the petitioner. Under such circumstances, a holding that the petitioner had forever forfeited its right to exemption would not be justified. Thus, whatever the correct interpretation of article 511 may be, the provisions of that article and its later counterparts afford no proper basis for denying exemption to the present petitioner."

The Commissioner, after he published his acquiescence in 1935 to this decision of the Board, continued to maintain that the regulations meant what they said. On May 12, 1945, the Commissioner mailed to petitioner Form 1025, the affidavit for organizations claiming exemption from tax. That form contained the following instructions from the Commissioner (R. 64-65):

"Unless the Commissioner has determined that an organization is exempt, it must prepare and file a complete income tax return for each taxable year of its existence. * * * As soon as practicable after the information and data are received, the organization will be advised of the Commissioner's determination, and, if it is held to be exempt, no further returns of income will be required."

In Economy Savings and Loan Co. v. Commissioner of Internal Revenue (6th Cir. 1946) 158 F. 2d 472,

where it was to the Commissioner's advantage to contend that the regulation—in providing that an organization need not file returns after it has established its right to exemption—should be applied literally, the Court held (at page 474): "This regulation has the force and effect of law".

We point out again: The issue here is *not* the legal consequences of a *failure to comply* with the regulations, but the legal consequences of compliance.

* Respondent's brief (pp. 24-25, footnote 11) states that T. D. 5381 (1944 C.B. 188) *eliminated*, with respect to proof of exemption on or after January 1, 1943, the provision in the regulations which read: "When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income * * *."

Actually, the quoted sentence was not eliminated from the regulations under section 101. T. D. 5381, in order to conform the regulations with the Revenue Act of 1943 (which made the filing of Form 990 a statutory duty), merely changed the heading to the then existing regulations to read as follows: "Proof of exemption prior to January 1, 1943. —Annual returns for accounting periods beginning prior to January 1, 1943"; and the above quoted sentence was retained without change in the regulations for taxpayers who made proof of exemption prior to January 1, 1943.

T. D. 5381 also added a new section to the regulations with the following heading: "Sec. 29.101-2. Proof of exemption on or after January 1, 1943.—Annual returns for accounting periods beginning on or after January 1, 1943." The last paragraph in the new section provided (1944 C.B. 188, 192):

"An organization which has established its right to exemption from tax under section 101, including *an organization which is relieved under section 54(f) and these regulations from filing returns of income or annual returns of information*, is not, however, relieved from the duty of filing other returns of information (see sections 147 and 148)." (Emphasis supplied)

Thus, the regulations under section 101, both before and after the amendment in 1944 by T. D. 5381, instructed petitioner that, having established its right to exemption, it was relieved from filing income tax returns.

B. The G.C.M. Was Not Notice to Petitioner

The Commissioner strenuously contends that the taxpayer received due notice in 1943 of the proposed revocation (or perhaps of the revocation itself!) (Br. 34-35). Suffice it to say that the record is silent. There is nothing in the record to support even an inference of notice. Both the Tax Court and the Circuit Court of Appeals below refused to accept the Commissioner's contention.

The Commissioner relies upon the publication of the General Counsel's Memorandum (G.C.M. 23688, 1943 C.B. 283). In view of his willingness to repudiate the regulations under section 101, it is not surprising that the Commissioner attempts to promote the legal status of a G.C.M. (Br. 14, 16, 21). However, no G.C.M. has or can have the force, effect, or dignity of a Commissioner's ruling or a Treasury regulation. An opinion from the Commissioner's General Counsel to the Commissioner for the Commissioner's consideration, which he may or may not follow, has in fact and in law no legal status whatsoever. Even the Internal Revenue Bulletin in which the G.C.M. was published fails to support the Commissioner's present position.⁵ (The full text of the G.C.M. is set forth in an Appendix to

⁵ The front page of the Internal Revenue Bulletin for 1945 stated: "The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Bureau of Internal Revenue; the rulings other than Treasury Decisions have none of the force or effect of Treasury Decisions and do not commit the Département to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury." (Emphasis supplied)

While Congress has provided that the publication of rules and regulations in the Federal Register gives legal notice of their contents (49 Stat. 502), neither the Congress nor the Treasury has made any such provision with respect to publications in the Internal Revenue Bulletin.

this brief.) Nor did the Commissioner himself consider it notice to the petitioner⁶ nor even to the taxpayer involved.⁷

The G.C.M. itself establishes that it was not intended as a general notice, and certainly not as notice to the petitioner. Furthermore, it was based upon an unpublished decision with respect to the imposition of the dues tax (sec. 1710, Internal Revenue Code of 1939) upon dues to a health club. Neither before nor since the publication of the G.C.M. (throughout the 30 years of the existence of the dues tax there referred to) has anyone asserted that the dues tax applied to the dues paid to the petitioner.

C. The Commissioner's Denial of Discrimination

The Commissioner now contends that his arbitrary and unfair action (his contention, of course, being that the action was neither arbitrary nor unfair—Br.

⁶ Neither the letter of June 11, 1934 (R. 48), nor the letter of July 5, 1938 (R. 59), in ruling that petitioner was exempt, suggested that the rulings were subject to revocation, retroactively or prospectively, by the publication of a G.C.M. (or even a general ruling by the Commissioner) in the Internal Revenue Bulletin. The Commissioner's letter of May 12, 1945, while referring to the G.C.M. (R. p. 59, 1st full par. p. 60), fails to claim that it gave notice and denies that it was a ruling. The Commissioner's letter of July 16, 1945 (R. p. 66) merely refers to the G.C.M. and properly labels it as an "opinion".

Had the Commissioner intended that the G.C.M. was notice to the taxpayer here involved, he would at least have stated what he sometimes states in other revenue rulings. See, for example, Rev. Rul. 209, 1953-2 C.B. 104, where the Commissioner tried to make the publication of Rev. Rul. 209 a revocation *for the future* of prior individual rulings with respect to the qualification as insurance of self-insured plans of employers.

⁷ Although the record is silent, we have recently learned, and the Commissioner will not deny, that the taxpayer involved in the G.C.M. received a specific notice of revocation of its prior tax-exempt ruling by letter from the Commissioner dated June 11, 1943.

pp. 33, 34, 35) in refusing to follow the regulations and in his retroactive revocation of his rulings, was necessary (and therefore justified) in order that all the local automobile clubs should be treated alike. We admit that he has stated the only available argument. But since when has equality of treatment justified arbitrary and unfair treatment of a specific taxpayer? Seldom in the administration of the tax laws are all taxpayers, or even all taxpayers within a group, treated alike. This is particularly true when issues are involved in litigation. Rarely will taxpayers not involved in litigation suffer from a retroactive application of unfavorable judicial decisions. Usually, only the "guinea pig" is hurt.

But let us examine his assertion that all the clubs "be treated alike". Were they? Not one of the other clubs whose cases reached litigation was subjected to the treatment the petitioner received. In none of the other cases⁸ was the issue of retroactivity involved. In none was there a retroactive revocation of a tax-exempt ruling.⁹

⁸ *California State Automobile Association v. Smyth*, 77 F. Supp. 131 (Calif. D.C. 1948), reversed 175 F. 2d 752 (9th Cir.), cert. denied 338 U.S. 905; *Chattanooga Auto Club*, 12 T.C. 967 (1949), aff'd 182 F. 2d 551 (6th Cir.); *Warren Automobile Club, Inc.*, 8 T.C.M. 577 (1949), aff'd 182 F. 2d 551 (6th Cir.); *Keystone Automobile Club*, 12 T.C. 1038 (1949), aff'd 181 F. 2d 402 (3d Cir.); *Automobile Club of St. Paul*, 12 T.C. 1152 (1949).

⁹ In fact, it cannot even be said, from a reading of the decisions, that any of the other automobile clubs involved had complied with the regulations and obtained a determination from the Commissioner that they were exempt from taxation. In the case of the California State Automobile Association, it is clear from the opinion of the Ninth Circuit (175 F. 2d 752) that the club had not previously obtained a ruling as to its tax-exempt status.

In the case of the other automobile clubs involved in litigation, it is clear that they were notified by the Commissioner, shortly after the publication of *G.C.M. 23688*, to start filing income tax returns. The Automobile Club of St. Paul (12 T.C. 1152) was the last of the auto club cases—except for petitioner's case—to be decided by the Tax Court. In the findings of fact by the Tax Court, it was stated (p. 1156) that the Commissioner by letter dated October 9, 1943 notified the St. Paul Club it was not exempt and would be required to file returns for 1942 and subsequent years. Since all of the other automobile club cases were decided before the St. Paul Club case, it is reasonable to conclude that they received their notice to start filing returns before, or at about the same time, notice was given to the St. Paul Club.

Petitioner's tax-exempt rulings were revoked in 1945, and the Commissioner is attempting to tax it for the two years preceding the year of revocation. None of the other clubs mentioned were taxed for any year prior to the year in which they received notice to start filing income tax returns.

Furthermore, the Commissioner did not require all of the clubs to "start paying taxes as of the same time". For example, the Chattanooga Automobile Club (12 T.C. 967) was not taxed by the Commissioner for the first nine months of 1943, but only for the taxable year beginning October 1, 1943 and subsequent years.

The *best* the Commissioner can claim is that he made a noble effort to treat *some* of them alike.

THE ISSUE OF THE STATUTE OF LIMITATIONS

A. The Statute of Limitations Started to Run on Due Date of Return

Since the Commissioner had instructed petitioner—both by his regulations under section 101 and by the letter rulings issued to petitioner—not to file returns, petitioner contends (Br. 73-77) that the statute of limitations started to run on the date when the returns were due if petitioner had been under a duty to file them. *Balkan Nat. Ins. Co. v. Commissioner of Internal Revenue* (2nd Cir., 1939) 101 F. 2d 75; *Stockstrom v. Commissioner of Internal Revenue* (App. D. C. 1950) 190 F. 2d 283.

The Commissioner relies (Br. 40) on two decisions in his argument. *Schafer v. Helvering* (App. D. C. 1936) 83 F. 2d 317, aff'd, 299 U.S. 171; and *Southern Maryland Agricultural Fair Association v. Commissioner* (1939) 40 B.T.A. 549. It will be noted that the Court of Appeals for the District of Columbia Circuit, which decided the *Schafer* case in 1936, relied on by respondent, nevertheless found and applied an estoppel against the Commissioner in holding (in 1951) for the taxpayer in the *Stockstrom* case. While the *Schafer* case was affirmed by this Court, the issue of estoppel was not presented to, or decided by, this Court.

In the *Southern Maryland* case, the Commissioner stated in his Notice of Deficiency (40 B.T.A. 549, 550) "The officers of your corporation since 1921 have been making distributions to stockholders contrary to the basis on which the exemption was predicated, and must reasonably have known that the ruling of January

18, 1924 was not based upon a full knowledge of the facts."¹⁰

It should also be noted that in its opinion the Board stated (p. 554) that the taxpayer "might well have cited" the *Balkan Nat. Ins. case, supra*, even though the taxpayer's case was "less strong factually". In petitioner's case, unlike in the *Southern Maryland* case, there was no misrepresentation or concealment which induced the Commissioner to issue the rulings that petitioner was exempt from filing tax returns.

The Commissioner argues (Br. 42) that it must be assumed that the parties, in signing the agreements for extension of the period of limitations, did not intend a futile act. Under section 276(b) of the Internal Revenue Code of 1939, no agreement for the extension of the statute of limitations is valid unless executed within the time prescribed by the statute. The intentions of the parties are immaterial. See *Atlas Oil & Refining Corporation* (1954) 22 T.C. 552, 560.

B. Form 990 Constituted a Return for Purposes of the Statute of Limitations

In discussing the decision of this Court in *Commissioner v. Lane-Wells Co.*, 321 U.S. 219, the Commissioner (Br. 43) points out that his regulations required a personal holding company to file a separate return on Form 1120H, and in its opinion this Court stated that the regulation requiring two separate returns was

¹⁰ In the article "Taxpayers' Rulings" 5 Tax Law Review 105, by J. P. Wenchel, a former chief counsel of the Bureau of Internal Revenue, the author stated (p. 113) with respect to the *Southern Maryland* case: "... it appears that the facts had not been fully disclosed to the Bureau at the time the request for a ruling was made."

a reasonable and valid one, and the taxpayer had not complied with it.

But petitioner did comply with the regulations applicable to it. In filing Form 990, petitioner filed the only return form which the regulations required it to file.

The Commissioner contends (Br. 49) that the enactment of section 302(b) of the Revenue Act of 1950 indicates that Congress was of the opinion that the filing of Form 990 was insufficient to start the running of the statute of limitations. But section 302(b) did not say that a Form 990 will not constitute a return for the purpose of the statute of limitations unless it qualified under that section. Rather, the section prevents the Commissioner, in cases in which he had not already started proceedings against the taxpayers, from taking the position that Form 990 was insufficient to start the running of the statute of limitations. Congress left all other cases to be determined by the Courts on the basis of the existing law, and said nothing one way or the other as to how that issue should be decided.

Although the Commissioner stresses legislation in 1950, he fails to mention legislation in 1954. In the Internal Revenue Code of 1954 Congress provided, as the law for the future, that a Form 990 constitutes a return for the purposes of the statute of limitations. Section 6501(g)(2) of the 1954 Code provides as follows:

“(2) EXEMPT ORGANIZATIONS.—If a taxpayer determines in good faith that it is an exempt organization and files a return as such under section 6033, and if such taxpayer is thereafter held to be a taxable corporation for the taxable year for which the return is filed, such return shall be deemed the

return of the corporation for purposes of this section."

The foregoing section was clearly intended by the Congress to *settle* the law prospectively. But it cannot be said that Congress intended the section to change the law. To the contrary. Paragraph (1) of section 6501(g) expressly provided, for the first time, that if a corporation in good faith determines that it is taxable as a trust and files a return on the fiduciary form, such return shall be treated as starting the running of the statute of limitations for the assessment of the tax imposed against corporations—a proposition decided by this Court in 1940 in the case of *Germantown Trust Co. v. Commissioner*, 309 U.S. 304. Obviously, Congress was codifying the law as to trust returns and deciding that the same policy should apply to tax exempt organizations.

THE ISSUE OF PREPAID DUES

A. Petitioner's Method of Accounting Reflects Income on Annual Basis

In its main brief, after discussion of the decisions of this Court with respect to the claim of right doctrine, petitioner pointed out (Br. 36) that this Court can sustain petitioner's contention that it is entitled to take prepaid membership dues into account for tax purposes in accordance with its long-established method of accounting without reversing or modifying any of its previous decisions. The Commissioner does not appear to take issue with the petitioner on this point.

While the respondent cites several decisions¹¹ of this

¹¹ *Spring City Company v. Commissioner*, 292 U.S. 182. (A debt for goods sold on open account became partially worthless by the end of the year. The accrual basis taxpayer sought to exclude

Court not discussed in petitioner's brief, none of them dealt with the application of the claim of right doctrine, and none of them presented a situation where the Commissioner refused to accept, as he has in petitioner's case, a long-established method of accounting consistently applied by the taxpayer. These cases cited by respondent dealt with the tax treatment of an isolated transaction or event of the taxpayer, and did not involve the issue of whether a general method of accounting adopted by the taxpayer and consistently applied from year to year, clearly reflected income for tax purposes.

Petitioner, of course, does not take issue with the proposition that under our tax system of annual accounting a taxpayer cannot postpone the assessment of taxes until it has been determined whether a given transaction engaged in during the taxable year resulted in a gain or a loss. Petitioner's case presents no such

the debt from gross income or, contrary to applicable law, to deduct the debt to the extent worthless.)

Burnet v. Sanford & Brooks Co., 282 U.S. 359. (Taxpayer recovered an award to compensate for losses sustained from a long-term dredging contract. It sought to depart from its established method of filing returns on the cash basis and relate the award back over the years of the contract.)

Guaranty Trust Company v. Commissioner, 303 U.S. 493. (Involving the distributive income of a partnership filing returns on a fiscal year basis. Included in the taxable income of a deceased partner was the distributive income for the fiscal year ending in the year of his death and the income earned thereafter to the date of death.)

Heiner v. Mellon, 304 U.S. 271. (Involving distributive profits of a partnership formed to liquidate assets of a whisky distilling and storage business formerly conducted in corporate form. The partners sought to exclude the distributive profits from their annual returns until the final year of liquidation.)

issue. The petitioner has not substituted for an annual system of accounting a basis of "finally ascertained results of particular transactions", as the Commissioner argues (Br. 55). To the contrary, petitioner's method of keeping its books and filing its returns consistently reflects income earned and expenses incurred on an annual basis without regard to whether profit or loss is realized from particular transactions or from particular membership accounts.

The Commissioner's argument completely fails to meet the issue—whether the petitioner's method of accounting clearly reflects income. At no point in his Brief does the Commissioner contend that the petitioner's method fails to clearly reflect income. The Commissioner fails to take issue with petitioner's assertion that the Commissioner's method distorts income. Certainly, before the Commissioner is permitted to substitute his method of accounting for the petitioner's method, it is incumbent upon him to establish that his system *more clearly* reflects income than petitioner's method.

B. The Repeal of Sections 452 and 462

The respondent contends (Br. 61) that the *action of Congress* in enacting sections 452 and 462 of the Internal Revenue Code of 1954 and *in subsequently repealing those sections* makes clear the correctness of the Commissioner's position with respect to the tax treatment of the prepaid income in petitioner's case. The Commissioner commits two errors in making that contention. First, he forgets or disregards the written assurances given by the Secretary of the Treasury on March 22, 1955 to the Committee on Ways and Means that "the Treasury Department will not consider the

repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and *other items of prepaid income*, either under prior law or under other provisions of the 1954 Code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decision." (Emphasis supplied)¹²

The second error of the Commissioner is in concluding that the action of Congress in repealing section 452 makes clear the correctness of the Commissioner's position on prepaid income. Rather, the committees of Congress in charge of the bill (H.R. 4725, 84th Cong.) which repealed section 452 made it abundantly clear that they were not approving or endorsing the Commissioner's position. The views of the Committee on Ways and Means in this respect were set forth in petitioner's opening brief (p. 43).

The Senate Finance Committee in its report (S. Rep. No. 372, 84th Cong., 1st Sess.) expressed approval—rather than neutrality or disapproval—of the decision of the Tenth Circuit in *Beacon Publishing Company v. Commissioner*, (1955) 218 F. 2d 697, on which petitioner relies. After referring to the decision, the report stated (p. 5):

"It is recommended to the Treasury Department that it modify its published ruling [I.T. 3369, 1940-1 C.B. 46] to the end that the remaining publishers may be entitled to defer prepaid sub-

¹² The letter of the Secretary of the Treasury, to the Chairman of the Committee on Ways and Means, containing such assurances, is set forth in H. Rep. No. 293, 84th Cong., 1st Sess., pp. 4-5 (1955-2, C.B. 852, 855). These assurances, of course, were given to the Committee on Ways and Means *before* Congress repealed section 452, and not *after* such repeal, as stated by respondent (Br. 64).

scription income so that they may be placed upon a *fair and equitable basis*." (Emphasis supplied)

Moreover, the Senate Finance Committee report refutes the suggestion made by respondent (Br. 65, footnote 47) that there was an understanding by Congress that the settlement of the rules in the field of prepaid income and prepaid expenses should be left to Congress without help from the courts. In this connection, the Senate Finance Committee report stated (p. 5-6):

"Uncertainty will also exist in other areas with the repeal of these two provisions. In *Pacific Grape Products* (C. C. A. 9th, February 10, 1955) [219 F. 2d 862], for example, the circuit court held that certain freight and shipping expenses incurred after the end of the year could be accrued for tax purposes as of the end of the year. An extension of the principles laid down in this case might well lead the courts in the future to permit the accrual of most estimated expenses which would be covered by section 462 even though this section is repealed."

This statement does not indicate that Congress suggests—pending new legislation—that the courts abdicate and stamp approval to any position taken by the Commissioner in the field of prepaid income and estimated expenses. Rather, the Committee Reports express approval of the recent decisions (*Beacon Publishing Company*, and *Pacific Grape Products*) which rejected the Commissioner's position; disagree specifically with many of the Commissioner's actions; and state that Congress will correct the Commissioner's errors if and to the extent that the judiciary fails to correct them.

Sections 452 and 462 of the Internal Revenue Code of 1954 were repealed in 1955 when it became apparent

that the loss of revenue during the period of transition would be very much greater than had been estimated in 1954 when the sections were enacted (H. Rep. 293, *supra*, p. 3). While the Commissioner refers (Br. 64) to the loss of revenue which would have resulted, it is not believed that he is suggesting that a decision from this Court favorable to petitioner would create a similar problem.

The loss of revenue under sections 452 and 462 was purely a transitional problem. Taxpayers electing to use those sections could do so without obtaining the consent of the Commissioner to change their method of accounting for tax purposes. No revenue escapes tax when a taxpayer consistently files his returns under one method of accounting. But when consistency is abandoned, and there is a shift from one method of accounting to another, distortions will arise. If a taxpayer prior to 1954 was not filing his returns in accordance with the method described in section 452 or 462, his use of either section for 1954 would produce a decrease in the net income for the year as compared to what he would otherwise have reported without making the shift. The repeal of sections 452 and 462 gave Congress an opportunity to prescribe rules which would allow the shift with less effect on the revenues during the transition period.

But in petitioner's case there is no year of transition—it has kept its books since 1934 on one basis and filed its returns on that basis. Furthermore, if other taxpayers receiving prepaid income have been filing returns on the cash basis acceptable to the Commissioner, they cannot—upon the approval by this Court of the use by petitioner of its method of accounting—change to petitioner's method without first obtaining the consent of the Commissioner (a condition which,

as previously stated, was not required under sections 452 and 462).

Section 446 (e) of the Internal Revenue Code of 1954 provides as follows:

“(e) Requirement Respecting Change of Accounting Method.—Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, *secure the consent of the Secretary or his delegate.*” (emphasis supplied)

The Commissioner's regulations will not permit a change in an accounting method unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. Section 39.41-2(c) of Regulations 118, the last regulations promulgated on this point, provide as follows:

“A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. For the purposes of this section, a change in the method of accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, * * *. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. * * *”

Thus, it is clear that the problem which occasioned the repeal of sections 452 and 462 cannot arise as a result of a decision of this Court holding that petitioner was entitled to take prepaid membership dues into income for tax purposes in accordance with its long-established method of accounting.

SUMMARY OF CONTENTIONS

For the convenience of the Court, we summarize the petitioner's contentions and attempt to summarize the Commissioner's contentions as we understand them:

I. The Retroactive Revocation Issue

(a) The petitioner contends that the Commissioner had no power to revoke, retroactively, the specific tax-exempt rulings issued the petitioner; that neither the statute nor the regulations confer that power; and that the regulations deny the power. The Commissioner contends that the rulings were founded upon a mistake of law; that they were merely advisory; and that they had no legal effect. The Commissioner also contends that power to revoke the rulings retroactively is found by implication in section 3791(b) of the Internal Revenue Code of 1939, and that the regulations under section 101 have no legal effect and should not be taken seriously, even by one who has complied with them and relied upon them.

(b) The petitioner contends that, even if the Commissioner had power to revoke, retroactively, the specific tax-exempt rulings, his action was arbitrary and discriminatory, without notice to the petitioner, in violation of his declared policy and long-standing practice, and that his attempt to revoke retroactively had no legal effect. The Commissioner contends that the publication of the General Counsel's memorandum in 1943 constituted adequate notice to the petitioner; that the petitioner doubtless received notice from one or more other automobile clubs; and that notice from the Commissioner was not required. The Commissioner asserts that his action was not arbitrary or discriminatory because it was necessitated by a desire to

treat all automobile clubs the same and that this objective justified his action.

II. The Statute of Limitations Issue

The petitioner contends that the statute of limitations bars the proposed deficiencies for the years 1943 and 1944; that the regulations relieved him of duty to file income and excess-profits tax returns for the years in question; and that in filing the tax-exempt return for each year in question, as required by section 54(f) of the Internal Revenue Code of 1939 (added by the Revenue Act of 1943), petitioner filed the only return he was required to file under the regulations, and that such return was "the return" within the meaning of section 275(a) of the Internal Revenue Code of 1939. Therefore, there was no "failure to file a return" within the meaning of section 276(a), and the three-year statute of limitations started to run on the date on which the income and excess-profits tax returns were due had the petitioner been under a duty to file them; that in any event the statute of limitations started running no later than the date upon which the return prescribed by section 54(f) and the regulations was filed; and the three-year period had expired. The Commissioner contends that only the filing of an appropriate income tax return and an appropriate excess-profits tax return meets the requirements of the statute, and that the statute of limitations cannot start running prior to the date on which such returns are filed.

III. The Method of Accounting Issue

The petitioner contends that its method of accounting, adopted in 1934 when petitioner was exempt from taxation and applied consistently since then, is a recognized and appropriate "method of accounting regularly

employed", within the meaning of section 41 of the Internal Revenue Code of 1939; that this method clearly reflects its income within the meaning of section 41 and is one of the methods recognized in section 42; that the method employed by the Commissioner distorts its income; and that none of the decisions of this Court are to the contrary. The petitioner also contends that the method employed by the Commissioner requires a reporting of its income from dues on a cash basis, and all its other income and all its expenses on the accrual basis, contrary to the decision of this Court in the *South Texas Lumber Co.* case. The Commissioner relies primarily upon the so-called "claim of right" doctrine; considers the failure to attempt to "match" the dues received with the obligations imposed upon the petitioner by its acceptance of the dues, merely an unfortunate consequence; and asks this Court to disregard the *Beacon Publishing Company* decision.

CONCLUSION

For the reasons stated in our main brief and here, it is respectfully submitted that the judgment of the Court below should be reversed with instructions to expunge the deficiencies found below for the years 1943 and 1944, and to compute petitioner's income from membership dues in accordance with the method of accounting employed by the petitioner.

Respectfully submitted,

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Dated: March 5, 1957

APPENDIX

G. C. M. 23688 (1943 C. B. 283)

Section 19.101(9)-1: Social clubs.

INTERNAL REVENUE CODE AND PRIOR REVENUE ACTS.

The M Association, functioning as a federation of automobile clubs and managing agency of several local automobile clubs, is not a "club" within the meaning of section 101(9) of the Internal Revenue Code and corresponding provisions of prior Revenue Acts, nor is it organized and operated exclusively for pleasure, recreation, and other nonproftable purposes within the meaning of that section.

G. C. M. 3555 (C.B. VII-1, 117 (1928)) and G. C. M. 2867 (C.B. VII-1, 115 (1928)) revoked. Recommended that O. D. 643 (C.B. 3, 241 (1920)) be revoked and that I. T. 2106 (C.B. III-2, 228 (1924)) be modified.

Reconsideration has been given to the status of the M Association as a club under the provisions of section 101(9) of the Internal Revenue Code and corresponding provisions of prior Revenue Acts. The status of the M Association (under the provisions of section 231(9) of the Revenue Act of 1926 and corresponding sections of prior Revenue Acts) was considered previously in G.C.M. 3555 (C.B. VII-1, 117 (1928)), in which the association was held to be exempt from taxation "as a club organized and operated exclusively for pleasure, recreation, and other nonproftable purposes."

The objects and purposes of the M Association (hereinafter referred to sometimes as the association) are stated in its by-laws, effective January —, 1941 as follows:

- a. To aid in the establishment and maintenance of a uniform and stable system of laws relating to the regulation and use of automobiles and motor vehicles, and the rights and privileges of the owners and users thereof.

b. To promote the construction, maintenance, improvement, and supervision of highways that are safe, convenient, and accessible to motor vehicles.

c. To educate the users of motor vehicles and the public at large in the principles of traffic safety.

d. To collect and distribute information as to all matters or things of whatsoever character concerning motor vehicles, or of interest to the users thereof.

e. To conduct and participate in exhibitions, contests, and safety activities, and to offer and grant awards, in connection with the interests of the users of motor vehicles.

f. To organize, supervise, and grant affiliation to other corporations, associations, and organizations with objects and purposes similar to those of this corporation.

g. To engage in any activity permitted by law intended to further and protect the interests of the users of motor vehicles.

h. To do any and all acts or things incidental, necessary, or convenient to the accomplishment of these objects and purposes.

The M Association functions to a large extent as a federation of automobile clubs. It also functions as the managing agency of several local automobile clubs. In its capacity as a federation of automobile clubs until January —, 1941, the association recognized individuals as members of the organization. As of that date, however, it excluded individuals from membership by the following provisions in its by-laws, as amended:

Section —. Membership in this corporation shall be confined and classified as follows: (a) State associations, (b) automobile clubs, (c) automobile divisions, (d) commercial vehicle organizations.

Sec. —. Individuals who are, or become, affiliated with this corporation shall not be members, but shall be classified as regular and honorary associates, as hereinafter defined.

Prior to 1941, the by-laws made provision for membership as follows:

Membership in this corporation shall be divided into six classes: (a) State associations, (b) automobile clubs, (c) commercial passenger motor vehicle organizations, (d) individual members, (e) divisions of this association composed of members thereof, (f) honorary members.

Other provisions of the by-laws define regular and honorary associates as individuals who reside in territory not covered by member organizations, or individuals elected as honorary associates, and state that such individuals, as such, shall have no right to vote in the affairs of the corporation, but shall have all the privileges extended to other individuals by the corporation.

In functioning as a federation of automobile clubs, the association represents member clubs in matters pertaining to the establishment and maintenance of uniform motor vehicle laws and fair and equitable taxation of motor vehicles. It fosters adequate marking of highways and other means of increasing the safety of motorists. It produces and sells on a cooperative basis to its member clubs highway and travel information such as maps, tour guides, travel directories, and other supplies for distribution by such clubs. It sponsors automobile races and conducts certified tests to the end that sound engineering practices will be developed, leading to the improvement of the automobile.

Member clubs pay to the association a specified amount per member obtained by each club during each month. Upon obtaining membership, such clubs are franchised to cover a particular territory within that served by the M Association and are given the right to vote in the affairs of the corporation, through duly selected delegates, at the rate of 1 delegate (1 vote) for every 1,000, or fraction thereof, paid-up members, except in the case of commercial

vehicle organizations as to which delegates are allowed on a different basis.

In its capacity as a managing agency of several local clubs, the association controls the activities of various clubs and divisions. In so far as those organizations are concerned, there is no difference between a "division" and a "club" except in name. One of them is operated as an experimental club, and the others have been operated by the association because of inadequate facilities within the territories covered by them. None of the above-mentioned clubs or divisions is incorporated. Each of the organizations is recognized as a member of the M Association and is given a right to vote in the affairs of the corporation. The individual members of such organizations are not recognized under the by-laws of the association as members of the association. However, as members of the local organization, such individuals have the right to vote within that organization and thus to participate in the selection of the delegates to represent the organization in the affairs of the association. The dues paid by individuals to the several local organizations become a part of the total revenue of the association, and the expenses of such organizations are paid out of the funds of the corporation.

When an individual becomes a member of one of the local divisions or clubs, the M Association, through the local organization, undertakes to render to such individual certain services in connection with his automobile, which services are intended to result in monetary savings to the individual. The association has made arrangements with numerous garages and service stations throughout the areas covered by the clubs and divisions under its control whereby emergency road service is furnished to members free of charge, such services being paid for by the association. The road services include, among other things, 30-minute repair service, towage in the event that road repair is impractical, tire changing, battery changing with

the use of a free-rental battery, and delivery service of gasoline and other materials. In addition, a member may have his lights and brakes inspected and adjusted without cost. In the event of theft of a member's car, the association offers a reward for the arrest and conviction of the thief. If a member is arrested or detained by reason of any violation of a motor vehicle law, with certain exceptions, the association will pay the cost of bail bond in any amount not exceeding a certain maximum. Personal travel information and services are also furnished by the association. Arrangements have been made with another corporation whereby members of some of the local organizations may purchase insurance at a considerable saving in premiums. Arrangements have also been made with certain merchants in one area whereby members of one of the local organizations may purchase clothing, laundry, furniture, and automobile supplies at less than the usual selling prices of such articles. There appears to be no limitation upon the number of individuals who may become members of the organizations managed by the M Association.

No material group activities are carried on or sponsored by the M Association. Though there may be some minor social activity, it is confined to small groups and is not a general activity of any of the local organizations. The above-mentioned services, which constitute a major activity of the organization, do not afford opportunities for personal contacts between persons receiving such services. They are services rendered to the individual whenever he may be and whenever he may need them.

Section 101 of the Internal Revenue Code provides that the following organizations shall be exempt from taxation:

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

In G.C.M. 3555, supra, in reference to the instant organization, it was stated:

Although the association may not be compared to a small social club which meets at stated periods for the purpose of discussing matters such as art, literature, etc., yet it is a club organized for nonprofitable purposes. The magnitude of the association is such that to apply the test of an ordinary social organization is impossible. The fact remains that it is an association of individuals organized and operated for the pleasure, welfare, and recreation of the members thereof, and not organized or operated for profit within the ordinary meaning of the term.

It is believed that the status of the instant organization should be reconsidered to determine whether the holding that such an organization is a "club" within the meaning of the statute is correct, and, if it is a club, whether it is organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of the statute.

Two approaches to the question will be considered:

(a) In G.C.M. 13067 (C.B. XIII-2, 148 (1934)), it was determined that the term "clubs," as used in an earlier counterpart of the above-quoted statute, was intended to apply to organizations having individual members and not to associations composed wholly of artificial persons or member clubs. The instant organization was there distinguished on the ground that it was composed in part of individual members. However, the present by-laws of the instant organization, as quoted above, have excluded individuals from membership. Accordingly, as an association whose membership is composed wholly of other organizations, it is believed that the M Association does not qualify as a "club," under section 101(9) of the Internal Revenue Code, since January —, 1941.

(b) Even if the individuals who are members of "clubs" or "divisions" were also members of the association, it

is believed that the organization would not qualify as a "club" within the meaning of the statute. Although there is no statutory definition of the term "club," as used in section 101(9) of the Code, it is believed that the term contemplates a comingling of members, one with the other, in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club." Social activities among the members of the component parts of the instant organization are confined to small, random groups. No material group activity of any kind is carried on or sponsored by the association or any of its component parts, and it does not appear that there are any facilities for personal contacts among the members. It is represented that the "club" or "division" headquarters may be considered the "clubhouse" of each individual. While a clubhouse is not considered essential to the existence of a club, it does not appear that the headquarters, where practically the only activity is that of keeping records and dispensing personal information, would constitute a clubhouse in any real sense of the word. As the principal activity of the organization, with respect to the members of its component parts, is that of rendering personalized services in connection with the use of their automobiles, in the receipt of which each individual participates without contact with, or regard for, any other member, it does not appear that fellowship constitutes a material part of the life of the organization. It is to be noted, however, that fellowship need not be present between each member and every other member of a club, if it constitutes a material part of the life of the organization. In this respect, it is believed that a State-wide or Nation-wide organization, which is made up of individuals, but is broken up into local groups, satisfies this requirement if fellowship constitutes a material part of the life of each local group.

The term "clubs," as used in section 101(9) of the Code, supra, is used in the same sense as the term "club" is used in section 1710 of the Code and corresponding sections of the Revenue Acts relating to the taxation of dues or membership fees paid to "any social, athletic, or sporting club or organization." (See G.C.M. 13067, supra.)

In *Arner v. Rogan* (May 20, 1940, unreported), the District Court of the United States for the Southern District of California, Central Division, had occasion to consider whether the Biltmore Health Club was a "club" within the meaning of section 501 of the Revenue Act of 1926, as amended by section 413(a) of the Revenue Act of 1928 (now section 1710 of the Code). In concluding that the organization was not a club, the court said:

• • • at least there must be some sort of association or cooperation between the members in an effort to reach some common objective before we may consider that there is a club or organization.

In the course of its opinion, the court observed:

The evidence shows that members never met together or in committee and never participated in any activities which are normally carried on by members of clubs or similar organizations, nor is there evidence that the patrons were entitled by the terms of their contracts to so participate. • • •

Another factor given weight by the court was that:

• • • the Biltmore Health Club did not in practice restrict its membership, nor did it agree to do so. The only qualifications apparently were that the applicant be over 21, white, free from any contagious disease or dangerous physical condition, and able to pay the fees.

The necessary implication to be derived from the *Arner* case is that financial contribution by way of a fee charged by the organization does not amount to "association or

cooperation between the members in an effort to reach some common objective," but that there must be some participation by the members in activities ordinarily carried on by clubs, which activities are intended to culminate in the realization of a common objective.

The evidence in the instant case does not indicate that members of the M Association participate in activities normally carried on by members of a club. Generally, the activities of the association may be classed in two groups, namely, those relating to the promotion of highway and motoring improvements and those relating to the services offered to individuals. In so far as the promotion of highway and motoring improvements is concerned, it does not appear that any substantial part of the local membership of the organization participates in such activities. Individual members, as such, have no right to vote or participate in the affairs of the corporation. The by-laws restrict voting rights to member organizations. In so far as services to individuals are concerned, members participate only to the extent of receiving such services. Although it might be contended that the receiving of services constitutes a common objective of the local members, it can not be said that members participate in activities leading to the rendition of such services, except to the extent that they make a financial contribution by way of a fee charged by the local organization. The principal activity of the M Association with respect to individuals, as stated above, is that of rendering services to motorists. Printed matter used in the solicitation of new members emphasizes the protection, service, and savings that accrue to members. It is reasonable to presume, then, that the actuating motive of individuals in joining the organization is to secure the convenience and savings afforded by services offered by the organization, and not to participate in any common objective proposed by the executives of the organization.

Although it should not be taken as the sole criterion, it is to be noted that no limitations are placed on membership by individuals. Organization members are limited to the extent that two franchises will not be given for the same territory. As to individuals, the organization is open to anyone who has not been convicted of manslaughter, negligent homicide, or hit-and-run or drunken driving, and who can pay the annual fee.

Upon reconsideration of the issue on the basis of the facts now presented, it is the opinion of this office that the M Association is not a "club," within the meaning of section 101(9) of the Internal Revenue Code and corresponding provisions of prior Revenue Acts.

Even though the association qualified as a "club" within the meaning of the statutes, it is not believed that it would be entitled to exemption as a club "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes."

It is well recognized that exemption provisions, such as section 101(9) of the Code, *supra*, are to be strictly construed. In *Chicago Theological Seminary v. Illinois* (188 U.S. 662), the Supreme Court of the United States stated in part as follows:

The rule is that, in claims for exemption from taxation under legislative authority, the exemption must be plainly and unmistakably granted; it can not exist by implication only; a doubt is fatal to the claim.

Under the rule of *noscitur a sociis*, the test of exemption is whether a club is organized and operated exclusively for pleasure, recreation, and other *similar* non-profitable purposes. It appears, then, that section 101(9) of the Code, *supra*, contemplates a club which devotes itself *exclusively* to activities in the nature of pleasure and/or recreation.

The principal activity of the M Association is that of rendering services to members in connection with the repair, maintenance, and use of their automobiles. In such respect, the organization operates in the nature of a nonprofit cooperative buying association. From the standpoint of the pleasure and recreation to be derived from the use of an automobile, most of the services offered are of the type available to motorists generally on a commercial scale at greater cost. Upon the payment of an annual fee, a member becomes entitled to free emergency road services which include such things as 30-minute road repairs, towage, tire changing, and gasoline delivery. In addition thereto, free services include brake and headlight adjustments, protection from car theft, and bail bond service. Insurance coverage is furnished at reduced premium costs, and members are able to make certain purchases at less than market price. In view of the above, it appears that the association operates to a material extent as a service club and is not engaged *exclusively* in activities in the nature of pleasure and/or recreation within the meaning of the statute.

It is not believed that section 101(9) of the Code, *supra*, was intended to exclude from Federal income taxation a club wherein the principal activity is that of rendering services of a commercial nature to members at a lower cost than would be paid elsewhere, even though the club derives no profits from such activity.

In view of the foregoing discussion and conclusions, G.C.M. 3555, *supra*, and G.C.M. 2867 (C.B. VII-1, 115 (1928)) are revoked, and it is recommended that O.D. 643 (C.B. 3, 241 (1920)) be revoked and that I.T. 2106 (C.B. III-2, 228 (1924)) be modified to conform to the views expressed in this opinion.

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 177a-204a¹) is reported at 20 T. C. 1033. The opinion of the Court of Appeals (Pet. 4a-34a) is reported at 230 F. 2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1956. (Pet. 35a.) The petition for a writ of certiorari was filed on May 15, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

¹ References to R. pages 1a-206a are to the record appendix to taxpayer's brief in the court below; references to R. 1b-9b are to the record appendix to the Commissioner's brief in the court below.

QUESTIONS PRESENTED

1. Whether the amount of membership dues paid to taxpayer during the taxable years should be accrued as income for the respective years in which received.

2. When in July, 1945, the Commissioner correctly held that taxpayer was not exempt from income taxes as a social club within the meaning of Section 101 (9) of the Internal Revenue Code of 1939, was he estopped by erroneous prior rulings, that taxpayer was exempt under corresponding sections of the Revenue Acts of 1932 and 1936, from requiring payment of taxes for 1943 and 1944?

3. Whether the statute of limitations barred assessment of deficiencies for 1943 and 1944.

STATUTE AND REGULATIONS INVOLVED

Sections 41, 42 (a), 52 (a), 54 (a), (b), and (f), 101 (9), 275 (a), 276 (a) and (b), and 3791 (b) of the Internal Revenue Code of 1939,² and Sections 29.52-1, 29.101-1, 29.101-2 (a), (c), (e), (g), (i), and (j) and 29.101 (9)-1 of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 18-28.

STATEMENT

Taxpayer, a nonprofit corporation without capital stock or shares, seeks review by this Court of three of the four disparate issues decided by the courts below. For convenience, these issues are discussed here in the order in which the petition raises them,

² Unless otherwise noted, references to the "Code" or the "Internal Revenue Code" will be to the Internal Revenue Code of 1939.

although this departs in stress and in sequence from their treatment in the lower courts. The Tax Court's opinion rendered *en banc* was unanimous (R. 204a); in the Court of Appeals dissent was expressed only with reference to the question here numbered "2" (p. 2, *supra*; Pet. 15a).

1. Taxpayer's returns for each of the taxable years 1943 through 1947 were prepared on the calendar year basis and on the accrual method of accounting. (R. 194a.) Its dues were payable annually in advance. (R. 180a, 194a.) Dues collected were not segregated from its general funds, but were deposited by taxpayer in the general bank account in which all of its other receipts were deposited. (R. 193a.)

On its books taxpayer credited the dues to an account carried as a liability account, designated "Unearned Membership Dues." During the first month of membership and each following month 1/12 of the amount paid was credited to an income account designated "Membership Income." In its returns for 1943 through 1947 taxpayer reported income from membership dues under this method. On the other hand, the Commissioner determined that the actual amount of membership dues paid to taxpayer should be reported as income for the year in which received. (R. 194a.) Both courts below unanimously sustained the Commissioner on this issue. (R. 195a-196a; Pet. 14a-15a.)

2. On June 11, 1934, the Commissioner wrote taxpayer that on the basis of evidence submitted taxpayer was entitled to exemption from income taxation under the provisions of Section 101(9) of the Reve-

nue Act of 1932, that, therefore, it was not required to file returns for 1933, and that under the provisions of corresponding sections of prior Revenue Acts and of the Revenue Act of 1934 it would not be required to file returns so long as there was no change in its organization, its purposes or methods of doing business. On July 5, 1938, a similar ruling was made by the Commissioner on taxpayer's claim for exemption under Section 101(9) of the Revenue Act of 1936. (Pet. 6a.)

In May, 1945, the Commissioner wrote taxpayer that the Bureau of Internal Revenue was reconsidering the question of exemption of automobile associations in the light of G. C. M. 23688, 1943 Cum. Bull. 283. (Pet. 6a.) Taxpayer having furnishing certain further information, the Commissioner on July 16, 1945, again wrote taxpayer and called attention to the fact that Section 101(9) of the Internal Revenue Code provides for the exemption of (R. 6a-7a)—

Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

The Commissioner's letter continued as follows (Pet. 7a):

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in or-

der for it to come within the meaning of the term "club."

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other nonprofitable purposes," within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

In compliance taxpayer filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest, on the ground that it was exempt. At the Tax Court hearing, however, taxpayer admitted that it was taxable for the period subsequent to July 16, 1945. (Pet. 8a.) Taxpayer urges, nevertheless, that the Commissioner erred in determining

a deficiency for any period prior to 1945, on the ground that he was estopped from retroactively revoking the prior determinations of a predecessor Commissioner. On this issue both courts sustained the Commissioner (R. 185a-189a; Pet. 8a-13a), Judge McAllister dissenting in the court below (Pet. 15a-34a).

3. The taxpayer did not file its 1943 and 1944 returns until October 22, 1945; it had been directed on July 16, 1945, to file them at the time the rulings of exemption were revoked. The parties on August 25, 1948, executed consents that the income and excess profits taxes could be assessed on or before June 30, 1949, and on May 23, 1949, executed similar consents extending the time for assessment to June 30, 1950. The notice of deficiency was mailed to taxpayer on February 20, 1950. (Pet. 13a.) Taxpayer contends that the three-year statute of limitations bars assessment of the deficiencies, asserting that the period for the two years involved commenced to run from March 15, 1944, and March 15, 1945, respectively. The Commissioner contends that the three-year statute began to run from the date the return was filed, namely, October 2, 1945. If this date controls the assessment is not barred. Taxpayer also contends that the dates on which it filed Form 990,³ namely, August 12, 1944, and May 17, 1945, started the running of the statute. Both courts unanimously sustained the Commissioner, holding that the statute started to run from October 22, 1945, and that the

³ Returns on Form 990 are information returns required of certain exempt corporations under Section 54 (f) of the Internal Revenue Code (Appendix, *infra*, pp. 19-20) and Treasury Regulations 111, Section 29.101-2 (Appendix, *infra*, p. 26).

information returns made upon Form 990 did not constitute the returns contemplated by Section 275 (a) to start the running of the limitations period. (Pet. 13a-14a; R. 189a-190a, 192a.)

ARGUMENT

1. The Tax Court and the court below were clearly correct in determining that membership dues paid in advance to taxpayer should be included in income in the year in which taxpayer received them. (R. 195a-196a; Pet. 14a-15a.) This money was received by taxpayer under a claim of right for its own use and deposited in its general bank account, subject to no restriction of any kind. (R. 193a.) Hence, the circumstance that the services which taxpayer obligated itself to render in return for the dues might be furnished in some cases in a succeeding taxable year in no way derogated from their character as income in the year of receipt. The statute nowhere limits taxable income to earned income. Income often does not represent a net figure and must be returned by a taxpayer, whether on the cash or the accrual basis, even though expenditures necessarily paid or incurred in consideration for its receipt may not be deducted until a future year. Internal Revenue Code, Sections 41 and 42 (a) (Appendix, *infra*, p. 18). This rule is settled by repeated decisions of this Court.^{*} The lower court decisions sustaining the doctrine are

^{*} *North American Oil v. Burnet*, 286 U. S. 417, 424; *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 363, 365; *Brown v. Helvering*, 291 U. S. 193; *Security Mills Co. v. Commissioner*, 321 U. S. 281; *United States v. Lewis*, 340 U. S. 590; *Healy v. Commissioner*, 345 U. S. 278.

The decisions make it clear that the rule applies to accrual as

legion and are by no means limited to cases where the right to income was in dispute.* (Pet. 9.)

Taxpayer asserts, however, that the decision below is in conflict with the decision of the Court of Appeals

well as cash basis taxpayers. See *North American Oil v. Burnet*, *supra*, at 421-22, 423-24; *id.*, 50 F. 2d 752, 755-56 (C. A. 9th); *Brown v. Helvering*, *supra*, at 199-200; *Clay Sewer Pipe Assn. v. Commissioner*, 139 F. 2d 130, 132 (C. A. 3d); *South Dade Farms v. Commissioner*, 138 F. 2d 818 (C. A. 5th).

* For example, *Blush v. Helvering*, 74 F. 2d 482 (C. A. D. C.), certiorari denied, 295 U. S. 732 (profits realized from stock sales, subject to the obligation to support market with a fund in a stated minimum amount by operating a trading pool for six months subsequent); *Fairmount Creamery Corp. v. Helvering*, 89 F. 2d 810 (C. A. D. C.) (interest received by corporation from employees to whom stock had been sold on credit, subject to refund in the event employee quit or was discharged); *Commissioner v. Lyon*, 97 F. 2d 70, 73-74 (C. A. 9th) (cash paid to lessor at beginning of ten-year term, subject to refund on termination of lease otherwise than by default of lessee); *First Nat. Bank v. Commissioner*, 107 F. 2d 141 (C. A. 6th) (proceeds of a note held taxable, notwithstanding contingent liability to repay at maturity if maker failed or if purchase of certain corporate assets was not consummated); *Detroit Consolidated Theatres v. Commissioner*, 133 F. 2d 200 (C. A. 6th) (sum received as advance rental deposit); *South Dade Farms v. Commissioner*, 138 F. 2d 818 (C. A. 5th) (sum received as advance rentals); *Clay Sewer Pipe Assn. v. Commissioner*, 139 F. 2d 130 (C. A. 3d) (prepayment for services to be rendered, although under contract recipient might be liable subsequently to return their equivalent); *DeGuire v. Higgins*, 159 F. 2d 921 (C. A. 2d) (dividends payable to purchaser of stock subject to possible refund under contract terms); *Capital Warehouse Co. v. Commissioner*, 171 F. 2d 395 (C. A. 8th) (prepayment for services whose cost taxpayer must defray in later year); *Haberkorn v. United States*, 173 F. 2d 587 (C. A. 6th) (bonus subsequently returned to employer because of error in calculation of profits, upon which the bonus was based); *Gilken Corp. v. Commissioner*, 176 F. 2d 141, 144-145 (sums received as advance rental deposit, security for performance and part payment of purchase price

for the Tenth Circuit in *Beacon Publishing Co. v. Commissioner*, 218 F. 2d 697 (Pet. 8-11), rendered by a divided court (Judge Bratton dissenting) subsequent to the decision of the Tax Court in the instant case.* While we respectfully submit that the majority opinion in the *Beacon Publishing Co.* case is incorrect, it is our view that this decision is nevertheless not in direct conflict with the decision of the court below. In the *Beacon Publishing Co.* case prepaid sums were received by taxpayer as payment for newspapers to be delivered in future years, while here the prepaid sums were received as payment for services. And there was present in the *Beacon Publishing Co.* case an administrative ruling which lent possible support to taxpayer's reasoning there. In I. T. 3369, 1940-1 Cum. Bull. 46, the Internal Revenue Service, recognizing that there were two methods by which accrual basis publishers had been accounting for prepaid subscriptions, had ruled that where a publisher "over a period of years" had reported an aliquot part of the subscription income over the subscription period, it would be permitted to continue to report the income in that manner and would not be required to change this accounting practice, pro-

should lessee exercise its option to purchase); *Booth Newspapers v. Commissioner*, 201 F. 2d 55 (C. A. 6th) (sum received by cash basis taxpayer as prepaid subscription for newspapers to be delivered in succeeding year); *Gordon's Estate v. Commissioner*, 201 F. 2d 171 (C. A. 6th) (sum received under lease with privilege to purchase); *Hyde Park Realty v. Commissioner*, 211 F. 2d 462 (C. A. 2d) (sum received as advance rentals).

* In a later case the Tax Court has expressed agreement with the dissenting opinion in the *Beacon Publishing Co.* case. *Andrews v. Commissioner*, 23 T. C. 1026, 1033.

vided that expenses applicable to obtaining the subscriptions were similarly allocated in the subscription period. Publishers who had been reporting the subscription income when received (see G. C. M. 20021, 1938-1 Cum. Bull. 157) were to continue to report the income in that manner." By contrast no administrative authority in support of taxpayer's position here may be claimed.

Moreover, the question which taxpayer seeks to raise does not seem appropriate now for decision by this Court. The Internal Revenue Code of 1954, as originally passed, contained in Section 452 detailed provisions authorizing deferral of income of accrual basis taxpayers to future years in certain cases of prepayment for services, goods or the use of property. Section 462 of the 1954 Code made correlative provision for permitting reserves to be set up in the taxable year for estimated future expenses. However, experience demonstrated that these sections would entail a much greater loss of revenue than originally estimated, and both were repealed. Section 1, Act of June 15, 1955, c. 143, 69 Stat. 134. Nevertheless, the committees of both Houses indicated that the subject was to be studied further with a view to legislation at an early date.' The Senate com-

H. Rep. No. 293, 84th Cong., 1st Sess., p. 4 (1955-2 Cum. Bull. 852, 854) stated:

"In view of the testimony received from taxpayers by your committee and the recognized desirability of conforming tax accounting to business accounting, your committee has instructed the staff of the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation to make studies of these accounting problems in an effort to provide conformance

mittee particularly referred to the uncertainty existing in the field of prepaid subscription income. S. Rep. No. 372, 84th Cong., 1st Sess., p. 5 (1955-2 Cum. Bull. 858, 861). However, while uncertainty may exist with respect to the status of prepaid subscription income, it is not present in the case of prepaid

of tax and business accounting without the transitional revenue loss. It has further requested each staff to report any suggested solutions to the committee as soon as feasible."

The Secretary of the Treasury wrote the Chairman of the Committee on Ways and Means as follows (H. Rep. 293, *supra*, p. 5 (1955-2 Cum. Bull. 852, 855)) :

"Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

S. Rep. No. 372, 84th Cong., 1st Sess., p. 6 (1955-2 Cum. Bull. 858, 861) declared:

"Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles. Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed."

membership dues, which fall within the general rule well settled by many decisions of this Court and of the lower courts. In the circumstances, and particularly in view of the Congressional recognition of a need for further study as a basis for anticipated legislation, it is believed that review of the question involved in the instant case is not warranted.*

Contrary to taxpayer's further contention (Pet. 8, 9-11) the decision of the Fifth Circuit in *Schuessler v. Commissioner*, 230 F. 2d 722, is not in direct conflict with the decision of the court below. There, an accrual basis taxpayer was permitted a deduction of an item representing a reserve for the estimated cost of carrying out a guarantee to turn on and off each year for five years furnaces sold in the taxable year. The income from the sales against which the guarantee was made was all reported in the taxable year. Thus, unlike the present case, the cited case does not represent a claim for deferring or spreading income received under claim of right over future years, but rather whether an asserted liability had actually been incurred in the taxable year or, on the other hand, was unsettled in amount and contingent in obligation and so not deductible until or unless incurred in the future.⁹ While problems with respect to deferral of

* It may be noted that a bill treating this problem, H. R. 10833, 84th Cong., 2d Sess., was introduced by Mr. Simpson of Pennsylvania, a member of the Committee on Ways and Means, on April 26, 1956.

⁹ Compare *E. H. Sheldon & Co. v. Commissioner*, 214 F. 2d 655, 656-657 (C. A. 6th); *S. Loewenstein & Son v. Commissioner*, 222 F. 2d 919 (C. A. 6th); and *Spencer, White & Prentiss v. Commissioner*, 144 F. 2d 45 (C. A. 2d), certiorari denied, 323 U. S. 780, with *Pacific Grape Prod. Co. v. Commissioner*, 219 F. 2d 862 (C. A. 9th).

prepaid income and deduction of estimated future expenses are related, and although in our view the reasoning and decision of the Fifth Circuit in the *Schuessler* case are incorrect (compare the contrary position of the Tax Court, 24 T. C. 247), the fact remains that there is not a direct conflict with the decision of the court below, for the cases involve different issues.

2. The Tax Court and the majority below correctly held that the Commissioner is not bound by his own or his predecessor's prior mistakes of law. (R. 185a-189a; Pet. 8a-13a.) The petition does not dispute the correctness of the Commissioner's ruling contained in his letter of July 16, 1945, that taxpayer was not exempt from tax under Section 101 (9) of the Internal Revenue Code (Appendix, *infra*, p. 20). (Pet. 6a.) At the Tax Court hearing taxpayer expressly admitted it was taxable for the period subsequent to July 16, 1945. (R. 148a; Pet. 8a.) And indeed the authorities compelled this concession.¹⁰ In exempting "clubs" under Section 101 (9) Congress referred to organizations whose members commingled in fellowship; in limiting the exemption to clubs organized and operated exclusively "for pleasure, recreation and other nonprofitable purposes," Congress meant non-profitable purposes similar to purposes of pleasure or recreation. Taxpayer, which per-

¹⁰ *Smyth v. California State Automobile Assn.*, 175 F. 2d 752 (C. A. 9th), certiorari denied, 338 U. S. 905; *Keystone Automobile Club v. Commissioner*, 181 F. 2d 402 (C. A. 3rd); *Chattanooga Auto. Club v. Commissioner*, 182 F. 2d 551 (C. A. 6th); *Automobile Club of St. Paul v. Commissioner*, 12 T. C. 1152; G. C. M. 23688, 1943 Cum. Bull. 283.

forms commercial services for its members, plainly falls outside the exempted class. (Pet. 7a-8a, 11a.).

The retroactive ruling of the Commissioner directing that tax returns be filed for 1943 and 1944 was authorized under Section 3791 (b) of the Code. (Appendix, *infra*, p. 21.) With respect to a predecessor of Section 3791 (b) under an earlier Revenue Act,¹¹ this Court held in *Helvering v. Reynolds*, 306 U. S. 110, 116, that it is clear Congress intended to give the Treasury power to correct misinterpretations "and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively."¹²

Surely, the Commissioner was not arbitrary in his exercise of the discretion conferred under Section 3791 (b) when, with the approval of the Secretary of the Treasury, he made his ruling of July 16, 1945, retroactive for only two of the twelve years between 1934 and 1945.¹³ Moreover, taxpayer does not assert

¹¹ Revenue Act of 1928, c. 852, 45 Stat. 791, Section 605.

¹² The 1928 Act dealt only with retroactive Regulations, but subsequent legislation, carried over into the Code, broadened the Commissioner's authority under this provision to include internal revenue rulings as well. Revenue Act of 1934, c. 277, 48 Stat. 680, Section 506. See also the committee reports which recommended this enactment. H. Rep. No. 704, 73d Cong., 2d Sess., p. 38 (1939-1 Cum. Bull. (Part 2) 554, 583); S. Rep. No. 558, 73d Cong., 2d Sess., p. 48 (1939-1 Cum. Bull. (Part 2) 586, 623).

¹³ G. C. M. 23688, referred to in the Commissioner's letters of May 12, 1945 (R. 83a-84a), and July 16, 1945, was published in the Internal Revenue Bulletin of July 11, 1943, as well as in the Cumulative Bulletin for 1943. It is not disputed that the M association which was the taxpayer involved in the cited ruling is

that it has altered its position to its detriment in reliance on the Commissioner's former ruling (Pet. 8a); nor does it show any prejudice resulting from the Commissioner's rulings as to 1943 and 1944, except the liability to pay taxes, which Congress required of every other taxpayer. A taxpayer has no vested interest in a mistaken construction of the statute by the Commissioner. And the Commissioner lacks authority to grant an exemption which Congress has not authorized.

3. The courts below were also correct in holding that the three-year statute of limitations¹⁴ on assessment began to run from the date that the returns

the American Automobile Association. Taxpayer was a member of the American Automobile Association to which it paid dues for 1943 and 1944 in excess of \$50,000 and for 1945, 1946 and 1947 in excess of \$60,000 (Schedule K of Exs. 13, 15, 17, 19 and 20, R. 2b, 3b, 5b, 7b and 9b), and was represented on its board of directors. G. C. M. 23688 not only specifically set forth the grounds for correct interpretation of Section 101(9), but also afforded clear evidence that its holding governed individual automobile clubs, such as taxpayer, for its recommended revocation of published exemption rulings of individual clubs. 1943 Cum. Bull. 288. The Tax Court found that so far as appears from any case mentioned by taxpayer the Commissioner has made all revocations of his ruling of exemption with respect to automobile clubs effective in 1943. (R. 189a.) It will not be disputed that there were many such clubs and necessarily some period of time elapsed after the issuance of G. C. M. 23688 before the Commissioner could reconsider the exemption in the case of any particular club. Taxpayer's quotation (Pet. 15) from Rev. Rul. 54-164, 1954-1 Cum. Bull. 88, 92, omits the following:

"A revocation may be effected by a notice to the organization or by a ruling or other statement published in the Internal Revenue Bulletin applicable to the type of organization involved."

¹⁴ Internal Revenue Code Section 275 (a) (Appendix, *infra*, pp. 20-21).

were filed, namely October 22, 1945. (R. 190a-192a; Pet. 13a-14a.) Taxpayer's assertion (Pet. 18-19) that the returns were due in March, 1944, and March, 1945, and that the statute runs from these dates is answered by the provision of Section 276 (a) (Appendix, *infra*, p. 21) that in case "of a failure to file a return the tax may be assessed * * * at any time."

In an effort to avoid the consequences of Section 276 (a), the taxpayer mistakenly asserts that the running of the statute started from the March dates because, it is said, the Commissioner was to blame for the failure to file returns when due. (Pet. 19.) From and after July 16, 1945, when the Commissioner expressly required taxpayer to file returns, taxpayer was under an obligation to file. Its subsequent delay in filing for more than three months was not induced by the Commissioner. Nor was taxpayer's voluntary agreement twice to extend the time for assessment of tax induced by the Commissioner. (Pet. 14a).

The decisions of the Second Circuit in *Balkan Nat. Ins. Co. v. Commissioner*, 101 F. 2d 75, and of the Court of Appeals for the District of Columbia in *Stockstrom v. Commissioner*, 190 F. 2d 282, are plainly distinguishable on their facts and do not conflict with the decision below. In the *Balkan* case taxpayer's failure to file a return was due to an impossibility created by the Government when the Alien Property Custodian seized all of taxpayer's records and denied access to them. There, the deficiency notice for 1918 income was not mailed to taxpayer in Bulgaria until 1934. In the *Stockstrom* case, where

gifts for 1938 were involved and the notice of deficiency was not sent until 1948, the court held that, although no return had been filed, the purpose of the filing requirement had been fulfilled, since in 1941 the Government had come into possession of all the pertinent facts and the limitation period commenced to run as of that date.

The filing of the annual information returns (Form 990) required from certain exempt organizations did not commence the running of the limitation period. As held by both courts below, these returns did not contain the data necessary to enable the Commissioner to compute taxpayer's liability, and so could not serve to start the limitations period. (R. 192a; Pet. 14a.) *Commissioner v. Lane Wells Co.*, 321 U. S. 219; *John Ranz Charitable Tr. v. Commissioner*, 231 F. 2d 673 (C. A. 9th), pending on petition for certiorari, No. 145, this term.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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JULY, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer.

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(26 U. S. C. 1952 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To Determine Liability to Tax.*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

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(f) [As added by Sec. 417 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] Every or-

ganization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

(9) Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

(26 U. S. C. 1952 ed., Sec. 101.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed

within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 3791. RULES AND REGULATIONS.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1952 ed., Sec. 3791.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.52-1. Corporation Returns.—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. * * *

Sec. 29.101-1 [As amended by T. D. 5381, 1944 Cum. bull. 188, 189] *Proof of Exemption Prior to January 1, 1943.—Annual Returns for Accounting Periods Beginning Prior to January 1, 1943.*—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption * * * under section 101 (9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations,

and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation * * *.

* * * * *

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations, or the purpose for which it was originally created, except that every organiza-

tion exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *.

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

Sec. 29.101-2 [As added by T. D. 5381, *supra*]. *Proof of Exemption on or after January 1, 1943.—Annual Returns for Accounting Periods Beginning on or After January 1, 1943.—(a) Proof of exemption.*—An organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of affidavit or ques-

tionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any collector: For organizations claiming exemption * * * under section 101 (9), Form 1025. * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

* * * *

(b) * * *

In addition to the information specifically called for by these regulations the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

* * * *

(c) *Collector's duties with respect to proof of exemption.*—The collector, upon receipt of the affidavit or questionnaire and other papers constituting the proof of exemption by an organization claiming exemption from tax under section 101, will forward completed documents

to the Commissioner for decision as to whether the organization is exempt.

(e) *Requirement of annual returns.*—For accounting periods beginning after December 31, 1942, every organization exempt from tax under section 101, regardless of the amount or source of its income or receipts and irrespective of whether it is chartered by, or affiliated or associated with, any central, parent, or other organization, except organizations specifically exempted from filing annual returns by section 54 (f) (see subsection (h) of this section), shall file annually with the collector for the district in which is located the principal place of business or principal office of the organization a return of information on Form 990 (revised May, 1944) specifically stating the items of gross income, receipts, and disbursements and such other information as may be prescribed by the Commissioner in the instructions on the form or issued by him therewith. * * *

(g) *Date for filing annual returns.*—The annual return of information, Form 990 (revised May, 1944), for accounting periods beginning after December 31, 1942, but ending prior to April 1, 1944; shall be filed on or before August 15, 1944, and for accounting periods beginning after December 31, 1942, but ending after March 31, 1944, shall be filed on or before the 15th day of the fifth full calendar month following the close of the period for which the return is required to be filed.

(i) *Collector's records.*—Collectors will keep a list of all organizations held to be exempt from tax to the end that they may occasionally inquire into their status and ascertain whether or not they are (1) observing the conditions upon which their exemption is predicated, and (2) annually filing returns on Form 990 (revised May, 1944) if they are required to file such returns.

(j) *Records, statements, and other returns of tax-exempt organizations.*—An organization which has established its right to exemption from tax under section 101 and has also established that it is not required to file annually the return of information on Form 990 (revised May, 1944) shall immediately notify in writing the collector for the district in which is located its principal office of any changes in its character, operations, or purpose for which it was originally created.

Every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of section 54 (f) and this section. For requirement as to keeping of permanent books of account or records, see section 29.54-1.

An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54 (f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the

duty of filing other returns of information (see sections 147 and 148).

Sec. 29.101 (9)-1. *Social Clubs*.—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE SIXTH CIRCUIT**

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (R. 144-169) is reported at 20 T. C. 1033. The opinions in the Court of Appeals (R. 190-219) are reported at 230 F. 2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1956 (R. 190). The petition for a writ of certiorari, filed on May 15, 1956, was granted on October 8, 1956 (R. 219). The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

2

QUESTIONS PRESENTED

1. Whether the Commissioner, having in 1943 published a correct ruling of general application that automobile clubs were not tax-exempt as social clubs, could in 1945 properly revoke prior erroneous rulings in favor of taxpayer and direct it to file tax returns for 1943 and 1944.

2. Whether assessment of deficiencies for 1943 and 1944 was barred by the statute of limitations.

3. Whether membership dues, received by taxpayer under a claim of right and without restriction, were includible in its gross income for the years in which such dues were received.

STATUTE AND REGULATIONS INVOLVED

Sections 41, 42 (a), 52 (a), 54 (a), (b), and (f), 101 (9), 275 (a), 276 (a) and (b), and 3791 (b) of the Internal Revenue Code of 1939, and Sections 29.52-1, 29.101-1, 29.101-2 (a), (b), (c), (e), (g), (i), and (j), and 29.101 (9)-1 of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 67-76.

STATEMENT

The facts relevant on this review, as stipulated (R. 16-105) and found by the Tax Court (R. 146-151, 156-157, 159-161), may be summarized as follows:

INTRODUCTION

The taxpayer was incorporated under the laws of Michigan on July 21, 1916. It was organized as a

¹ The questions are here stated in the order in which they were discussed by both courts below. In its brief before this Court, taxpayer has stated the third question first.

nonprofit corporation without capital stock and has never paid any dividends. (R. 146.)

During the taxable years involved, the number of taxpayer's members was approximately as follows:

1943-----	212,865
1944-----	224,092
1945-----	243,630
1946-----	261,005
1947-----	244,904

Taxpayer's by-laws provided for annual meetings of its members. Until some undisclosed time prior to March 15, 1947, twenty-five members constituted a quorum. Effective March 15, 1947, the presence of 10% of taxpayer's members was required to constitute a quorum. Taxpayer did not engage in or conduct any social activities. (R. 147-148.)

Taxpayer's members were of three classes—honorary, life, and active. Honorary membership was limited to twenty-five members, including certain government officials and other persons named by the board of directors. Honorary members paid no dues and had no voting rights. Life membership was obtained by an active member paying \$250 at one time. Life members were exempt from the payment of future dues and assessments but continued to have all the rights of active members. Active memberships were open to persons of good moral character over sixteen years of age. Active members paid dues of \$10 annually, except that as of October 1, 1946, such amount was increased to \$12. (R. 147.)

During the taxable years involved, the amount of dues which taxpayer collected from its members and its other principal items of revenue (including revenue from advertising in an organization periodical, the *Motor News*) were as follows (R. 69, 159):

	Dues	Rental income	Interest earned	Motor News advertising
1943.....	\$2, 126, 437. 50	\$36, 936. 48	\$34, 420. 90	\$47, 329. 50
1944.....	2, 237, 017. 04	37, 623. 25	40, 420. 10	55, 306. 55
1945.....	2, 430, 543. 97	39, 956. 48	40, 051. 06	71, 713. 14
1946.....	2, 744, 897. 65	58, 567. 52	41, 374. 74	81, 482. 50
1947.....	2, 914, 028. 78	48, 756. 48	39, 425. 75	82, 148. 00

Taxpayer's purposes or objects were stated in its Articles of Association, and in its by-laws as of January 1, 1940, as follows (R. 146) :

To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First" as applied to automobile traffic; to promote touring and to obtain and furnish touring information and obtain the necessary signboarding of public highways; and to co-operate in any work or movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general.

In January, 1941, taxpayer's by-laws were amended to provide that its funds should be used only to accomplish these objectives and should not inure or be distributed to its members (R. 42, 147).

Taxpayer's principal activity was the rendering of services to its members. These services included: furnishing emergency road service, supplying touring information, keeping members informed of matters of interest through publication and distribution of the *Motor News*, securing for members the benefits of

affiliation with the American Automobile Association, and providing for the purchase of automobile insurance by members.' (R. 62-63, 148.)

In its tax returns, taxpayer reported earned surplus and undivided profits at the beginning of each of the taxable years as follows (Schedule L, Exs. 13, 15; R. 68B, 76, 89):

1943	\$920,193.84
1944	1,046,230.85
1945	1,300,471.81
1946	1,385,905.01
1947	1,255,251.46

CLAIMED EXEMPTIONS FROM TAXATION FOR 1943 AND 1944

During the early part of 1934, taxpayer inquired of the Commissioner whether it was exempt from capital stock tax imposed by Section 215 of the National Industrial Recovery Act. In answer, the Commissioner informed taxpayer that it was first necessary to determine whether taxpayer was exempt from federal in-

* Among taxpayer's expenditures in rendering its services during the taxable years in issue were the following (Schedule K, Exs. 13, 15, 17, 19, 20; R. 71, 84, 182, 183, 184A, 185, 186A, 187, 188A, 189):

	1943	1944	1945	1946	1947
Emergency road service	\$548,364.50	\$302,912.00	\$875,279.00	\$651,720.00	\$895,000.07
Maps and guides	16,072.65	27,346.22	25,551.14	135,979.09	38,150.10
Printing, stationery and office supplies	216,471.78	225,998.25	232,183.83	289,638.24	335,250.55
Postage and mailing	49,051.22	56,724.00	59,501.02	50,278.57	55,085.88
AAA dues	52,909.25	55,776.00	60,060.50	65,176.75	61,001.50
Accident policy premiums	66,240.08	65,738.00	56,018.46	109,702.25	232,653.75
Commissions	178,129.59	135,775.77	160,007.12	201,959.87	116,580.06
Compensation of officers	35,100.00	35,496.02	38,086.23	37,855.70	37,915.00
Salaries and wages	542,247.01	577,533.56	678,067.51	803,906.89	912,317.04
Portion of expense charged to Detroit Automobile Inter-Insurance Association	159,919.27	171,999.74	189,753.91	221,375.72	271,225.63

	Dues	Rental income	Interest earned	Motor News advertising
1943-----	\$2, 126, 437. 50	\$36, 936. 48	\$34, 420. 90	\$47, 829. 50
1944-----	2, 237, 017. 04	37, 623. 25	40, 429. 10	59, 366. 55
1945-----	2, 430, 543. 97	39, 956. 48	46, 051. 06	71, 713. 14
1946-----	2, 744, 897. 65	58, 567. 52	41, 374. 74	81, 452. 50
1947-----	2, 914, 028. 76	48, 756. 48	39, 425. 75	82, 148. 00

Taxpayer's purposes or objects were stated in its Articles of Association, and in its by-laws as of January 1, 1940, as follows (R. 146) :

To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic

mine whether taxpayer was exempt from Federal in-

² Among taxpayer's expenditures in rendering its services during the taxable years in issue were the following (Schedule K, Exs. 13, 15, 17, 19, 20; R. 71, 84, 182, 183, 184A, 185, 186A, 187, 188A, 189):

	1943	1944	1945	1946	1947
Emergency road service.....	\$548,364.58	\$592,912.60	\$875,279.60	\$851,729.69	\$885,960.07
Maps and guides.....	16,072.65	27,346.22	25,551.14	135,979.09	58,150.10
Printing, stationery and office supplies.....	216,471.78	225,998.25	232,183.83	288,638.24	335,250.55
Postage and mailing.....	49,051.22	56,724.69	59,501.02	60,278.57	55,885.68
AAA dues.....	52,969.25	55,776.00	60,660.50	65,176.75	61,001.50
Accident policy premiums.....	66,240.98	65,738.00	58,018.46	109,702.25	232,653.75
Commissions.....	178,129.59	135,775.77	160,697.12	201,959.87	116,580.66
Compensation of officers.....	35,100.00	35,496.02	36,086.23	37,855.70	37,915.00
Salaries and wages.....	542,247.01	577,533.56	678,667.51	803,996.89	912,317.04
Portion of expense charged to Detroit Automobile Inter- Insurance Association.....	159,919.27	171,999.74	189,753.91	221,375.72	271,225.63

come taxation under the provisions of Section 103 of the Revenue Act of 1932. Accordingly, the Commissioner requested taxpayer to supply certain information concerning its operations, a copy of its financial statement for 1933 showing assets and liabilities, and a classified list of its receipts and disbursements. Taxpayer replied, enclosing a balance sheet showing its assets and liabilities as of April 30, 1934. On June 11, 1934, the Commissioner wrote taxpayer that on the basis of evidence submitted it had been concluded that taxpayer was entitled to exemption under the provisions of Section 103 (9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that taxpayer therefore was not required to file returns for 1933 and prior years; and that under the provisions of Section 101 (9) of the Revenue Act of 1934 taxpayer would not be required to file returns so long as there was no change in its organization, its purposes, or methods of doing business. (R. 148-149.)

In September 1937, the Commissioner sent taxpayer a questionnaire requesting certain information concerning its claim for exemption under Section 101 (9) of the Revenue Act of 1936. Taxpayer filled in the questionnaire and returned it to the Commissioner with a letter and a copy of its financial statement as of December 31, 1936. On July 5, 1938, the Commissioner wrote taxpayer that, since it appeared that there had been no significant change in its form of organization or activities, the previous ruling of the Bureau holding it exempt from filing returns of income was continued. (R. 149.) Section 101 (9) of the Revenue Act of 1936 was subsequently adopted as

Section 101 (9) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69).

On July 11, 1943, there was published in the Internal Revenue Bulletin an opinion by the Chief Counsel of the Bureau of Internal Revenue holding that the American Automobile Association, the national association of local clubs like the taxpayer, was not tax-exempt under Section 101 (9) of the 1939 Code. G. C. M. 23688, 1943 Cum. Bull. 283. As grounds for this conclusion, the Chief Counsel's opinion pointed out (1) that fellowship among members did not play a material part in the life of the organization, and (2) that the association was not organized and operated exclusively for pleasure, recreation, and other *similar* nonprofitable purposes. The ruling also expressly revoked, or recommended revocation of, previously published exemption rulings with respect to local automobile clubs. Taxpayer was a member of the American Automobile Association and during each of the taxable years paid that organization annual dues varying in amount from approximately \$53,000 to approximately \$65,000. (Schedule K, Exs. 13, 15, 17, 19, 20; R. 20, 182, 183, 185, 187, 189.)

On May 12, 1945, the Commissioner wrote taxpayer stating that the Bureau of Internal Revenue was re-considering the question of the exemption of automobile associations from federal income taxation in the light of the Chief Counsel's opinion. Taxpayer was requested to furnish the information called for in an exemption affidavit form which was enclosed. By letter dated June 11, 1945, taxpayer complied with

the Commissioner's request and enclosed the executed exemption affidavit together with a copy of taxpayer's articles of incorporation and by-laws and a copy of its balance sheet as at December 31, 1944. (R. 149-150.)

On July 16, 1945, the Commissioner wrote taxpayer as follows (R. 66-67):

Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G. C. M. 23688, C. B. 1943, 283.

Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103 (9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.

Section 101 (9) of the Internal Revenue Code provides for the exemption of:

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similar provisions.

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other non-profitable purposes", within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not

be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

Thereafter taxpayer filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest on the ground that it was exempt from tax. (R. 151.)

PERIOD OF LIMITATIONS ON ASSESSMENT OF DEFICIENCIES
FOR 1943 AND 1944

On August 12, 1944, taxpayer filed with the Collector for the District of Michigan, for the calendar year 1943, Treasury Department Form 990, an annual return which under Section 54 (f) of the 1939 Code (Appendix, *infra*, pp. 68-69) was required to be filed by organizations exempt from income tax under Section 101 of the 1939 Code. On May 17, 1945, taxpayer filed a like form for the calendar year 1944. These returns showed gross income and receipts and disbursements and contained statements of assets and liabilities at the end of the respective years. Such returns were not the returns required by Section 52 (a) of the 1939 Code (Appendix, *infra*, pp. 67-68) from corporations subject to tax under Chapter 1 of the Code and did not provide sufficient data from which taxpayer's income and excess profits tax liability for 1943 and 1944 could be computed and assessed. (R. 156.)

Taxpayer's income and excess profits tax returns (Forms 1120 and 1121) for the calendar years 1943 and 1944 were filed on October 22, 1945. On August 25, 1948, acting under Section 276 (b) of the 1939

Code (Appendix, *infra*, p. 70), taxpayer and the Commissioner entered into consent agreements which provided that the amounts of any income, excess profits, or war profits taxes for the taxable years ended December 31, 1943, and December 31, 1944, could be assessed at any time on or before June 30, 1949. On May 23, 1949, they executed consent agreements which provided that such taxes could be assessed at any time on or before June 30, 1950. The notice of deficiency forming the basis of this proceeding was mailed to taxpayer on February 20, 1950. (R. 156-157.)

ACCRUAL OF MEMBERSHIP DUES

The annual dues collected by taxpayer from its members were deposited in a general bank account maintained with the National Bank of Detroit. This was an account in which all money received by taxpayer was deposited. At no time were the dues segregated from taxpayer's general funds or deposited in a bank account other than the one general account in which all of its other receipts were deposited. (R. 159-160.)

Upon receipt of a member's dues, taxpayer set aside \$1 to pay for a subscription to *Motor News*. In the case of a new member brought in by one of taxpayer's solicitors or employees, a commission of \$2.50 was paid to the person bringing in the member. (R. 160.)

Prior to March 15, 1947, taxpayer's by-laws provided that a member whose annual dues remained unpaid for 30 days after becoming due was subject to suspension from the privileges offered by taxpayer. If a member failed to pay his dues within 30 days

after notice of his suspension, he ceased to be a member and became liable for two months' dues as well as the expense of collecting them. Any member who resigned forfeited all his rights and interests in taxpayer's property and assets. A new by-law effective March 15, 1947, provided for termination of membership by death, by resignation, by nonpayment of dues, or upon other reasonable cause by written notice to the member, such notice of termination to be accompanied by a check for the unused portion of annual dues as determined by taxpayer's board of directors. Taxpayer's board of directors has never adopted a resolution fixing the amount, or providing a formula for ascertaining the amount, of a refund to be paid to persons who ceased to be members of taxpayer. (R. 160.) Although prior to March 15, 1947, taxpayer's by-laws did not provide for the refunding of a portion of annual dues upon the termination of a membership, it had been taxpayer's policy since about 1924 to refund a portion of the unearned dues upon such termination. However, there was no inflexible rule under which the amounts of such refunds were computed.* (R. 160.)

* During the years in issue, the amount of dues collected and the amount actually refunded due to cancellation of memberships were as follows (R. 142-143, 159):

	Dues Collected	Refunds Due to Cancellation of Memberships
1943.....	\$2,136,437.50	\$13,204.23
1944.....	2,237,017.04	13,347.97
1945.....	2,430,543.97	17,492.74
1946.....	2,744,897.65	21,867.71
1947.....	2,914,028.76	24,778.87

Membership dues were paid in advance for one year. When a member's dues were received, taxpayer credited the amount of such dues to an account carried as a liability account and designated "Un-earned Membership Dues." During the first month of membership and each of the following eleven months, one-twelfth of the amount paid was credited to an income account designated "Membership Income." This practice with respect to membership dues has been followed by taxpayer since 1934 and the income from membership dues reported by taxpayer in its returns for 1943 through 1947 was computed in this manner. (R. 160-161.) During those years, as a result of this practice, the dues which taxpayer actually received exceeded the dues reported as income by the following amounts (Ex. 23, R. 106A):

1943-----	\$132,742.37
1944-----	82,879.34
1945-----	77,198.81
1946-----	145,919.02
1947-----	64,523.82

Taxpayer's returns for each of the years 1943 through 1947 were prepared on the basis of a calendar year and the accrual method of accounting. (R. 161.)

The Commissioner determined that the entire amount of membership dues received by taxpayer during the years involved should be reported as income for the years in which received. (R. 161.)

PROCEEDINGS BELOW

On the basis of the facts set forth above, the Tax Court, in an opinion reviewed by the full court, held: (1) that the Commissioner, having correctly ruled

dues upon such termination. However, there was no inflexible rule under which the amounts of such refunds were computed.* (R. 160.)

* During the years in issue, the amount of dues collected and the amount actually refunded due to cancellation of memberships were as follows (R. 142-143, 159) :

	Dues Collected	Refunds Due to Cancellation of Memberships
1943.....	\$2, 126, 437. 50	\$13, 204. 33
1944.....	2, 237, 017. 04	13, 347. 97
1945.....	2, 430, 543. 97	17, 492. 74
1946.....	2, 744, 897. 65	21, 867. 71
1947.....	2, 914, 028. 76	24, 778. 87

in July 1945 that taxpayer was not tax-exempt as a social club within the meaning of Section 101 (9) of the 1939 Code, properly revoked prior erroneous rulings that taxpayer was exempt under corresponding sections of the Revenue Acts of 1932 and 1936 and properly required payment of taxes for 1943 and 1944; (2) that the applicable statute of limitations did not bar assessment of deficiencies for 1943 and 1944; and (3) that the amount of membership dues paid to taxpayer during the taxable years should be accrued as income for the respective years in which received.* (R. 146-151, 156-157, 159-162.)

On appeal, the Sixth Circuit, Judge McAllister dissenting on the first issue, affirmed the decision of the Tax Court. (R. 190-219.)

SUMMARY OF ARGUMENT

I

The first issue, which relates only to the years 1943 and 1944, concerns the validity of the action taken by the Commissioner in July 1945 when, in accordance with the general ruling published in 1943 that automobile clubs were not tax-exempt as social clubs, he advised taxpayer of his determination that it was not tax-exempt, revoked prior inconsistent rulings in favor of taxpayer, and directed taxpayer to file tax returns (as distinguished from information returns) for 1943 and 1944. Taxpayer concedes that, under the applicable provisions of the Internal Rev-

* A fourth issue decided by the courts below, relating to the amounts allowable as depreciation deductions, is not presented for decision here.

enue Code of 1939, it was not tax-exempt for the years 1945, 1946, and 1947. From this concession, it necessarily follows (1) that taxpayer, whose activities remained substantially the same, was likewise not tax-exempt in 1943 and 1944 under the 1939 Code provisions, (2) that the published 1943 ruling was correct, and (3) that the prior inconsistent rulings in taxpayer's favor were erroneous. In discussing the question whether in July 1945 the Commissioner could properly revoke these earlier erroneous rulings and assess taxes for 1943 and 1944, it is pertinent to consider the nature of the earlier rulings, the Commissioner's statutory authority to issue new rulings retroactively, and the manner in which the Commissioner exercised his authority in this case.

A. In considering the nature of the earlier exemption rulings issued in 1934 and 1938, it is important to note that only Congress—and not the Commissioner—can relieve organizations of the obligation to pay taxes and to file tax returns. The Commissioner's function is limited to obtaining pertinent data and endeavoring to satisfy himself that taxpayers claiming such privileges are entitled to them. It was in the performance of that function that the Commissioner promulgated Regulations requiring the submission of data and issued the 1934 and 1938 rulings involved in this case. The Regulations did no more than specify what showing would be required to convince the Commissioner that the particular statutory provisions invoked by taxpayer applied. In 1935, the Board of Tax Appeals so construed these Regulations and the Commissioner published his ac-

quiescence in that decision. The 1934 and 1938 rulings, issued in accordance with these Regulations, did no more than advise taxpayer that the Commissioner concurred in its opinion that the applicable legislation excused it from paying taxes and filing tax returns. Noteworthy, too, is the nature of the error involved in these earlier rulings. The error was not in finding the facts or evaluating them; it was rather a pure error of law—an erroneous construction of the statute. The nature of that error is significant in that it resulted in the Commissioner's failure to assess and collect taxes imposed by Congress in accordance with the statutory mandate. When the existence of that error in earlier rulings was ascertained, the Commissioner was under an immediate duty to issue a new ruling to correct it.

B. Not only do various provisions of the Internal Revenue Code of 1939 clearly contemplate that incumbents of the office of Commissioner may make successive determinations of particular tax liabilities, but Section 3791 (b) expressly entrusts to executive discretion determination of the extent to which new rulings will be given retroactive effect.

C. And, not only did the taxpayer fail to prove that the Commissioner abused his discretion in making his 1945 ruling retroactive to 1943, the record establishes exactly the contrary. Thus, the principles of the 1945 ruling involved here had been announced in the general ruling published in 1943. That published ruling, which also revoked or recommended revocation of prior published exemption rulings in favor of local automobile clubs, was directed to the national organi-

zation of which taxpayer was a substantial dues-paying member and on whose board of directors taxpayer was represented. In reconsidering and revoking the many unpublished rulings in favor of other local automobile clubs, the Commissioner selected 1943 as the starting point for taxation of all of these clubs. Accordingly, all taxpayers—whether the previous exemption rulings which they had obtained were published or unpublished—were treated alike and the Commissioner's action clearly was not arbitrary.

Nor could taxpayer's failure to file tax returns for 1943 and 1944 possibly affect the Commissioner's power to revoke the prior exemption rulings and to direct taxpayer to file tax returns for those years. Thus, when the Commissioner in July 1945 revoked the earlier, erroneous rulings and directed taxpayer to file tax returns for 1943 and 1944, he could quite properly have then assessed deficiencies for 1943 and 1944, even if taxpayer had previously filed returns for those years.

II

The second issue, which also concerns only the years 1943 and 1944, involves taxpayer's alternative contention that, even if the action taken by the Commissioner in July 1945 was proper, assessment of the deficiencies for the years 1943 and 1944 became barred by the statute of limitations before the Commissioner mailed his deficiency notice. Under the provisions of Section 275 (a) of the Internal Revenue Code of 1939, however, the three-year statute of limitation starts to run only upon the filing of a tax return for the

particular year involved. Under the provisions of Section 276 (b), the time for assessing deficiencies may, before the expiration of the period, be extended and re-extended by agreement. Here tax returns for 1943 and 1944 were filed on October 22, 1945. Within three years thereafter, the period was extended by agreement. Within the extended period, the time was re-extended by a second agreement. Within the re-extended period, the deficiency notice was mailed. Accordingly, assessment of the deficiencies for 1943 and 1944 was not barred by the statute of limitations unless, as taxpayer contends, either the statute of limitations started to run before the filing of tax returns or certain information returns required to be filed by tax-exempt organizations constituted tax returns.

A. Taxpayer argues that the statute of limitations started to run prior to the time when tax returns were actually filed either (a) because it was not under a duty to file such returns or (b) because it was prevented from performing that duty by the Commissioner. This argument is based on two mistaken assumptions. First, it is erroneously assumed that the Commissioner could and did relieve taxpayer of the duty of filing tax returns. Second, it is mistakenly assumed that taxpayer was ready and willing to file tax returns before October 22, 1945, and that the Commissioner either deprived it of the opportunity or prevented it from doing so. Actually, however, the most that can be said for taxpayer is that its failure to file returns prior to July 1945 was due to a mutual mistake of law.

2 B. Assuming *arguendo* that the statute of limitation did not start to run before the filing of tax returns, taxpayer argues that the information returns which tax-exempt organizations were required to file should be held to constitute such tax returns. This argument ignores the purpose of having the statute of limitations start to run upon the filing of a tax return and misconceives the nature of the information return (Form 990). Under our self-assessment system, each taxpayer keeps his own records and from those records prepares and submits, on the form prescribed for the particular tax involved, the initial computation of his tax liability together with the required data. Deficiency assessments by the Commissioner are chiefly of a supplemental nature, designed to correct errors in the initial computations. Until the required data, with the initial computation, is submitted, the Commissioner is in no position to determine whether a deficiency assessment is necessary. Accordingly, in placing limitations on the period within which the Commissioner may assess deficiencies, it was only natural that Congress should provide that this period would begin only upon the filing of a return containing the data required for computation of the particular tax liability. The returns which taxpayer filed on October 22, 1945, were such returns. On the other hand, the information returns, which Congress required tax-exempt organizations to file, were designed for an entirely different purpose and did not require much of the data necessary for computation of the particular tax liabilities here involved. Those returns could not, therefore, be properly held

to constitute tax returns for the purpose of starting the running of the statute of limitations. Finally, the fact that Congress subsequently enacted special legislation under which such information returns would start the running of the statute of limitations in certain circumstances unlike those in the case at bar is further evidence that Congress did not intend such returns to be generally effective for that purpose.

III

The third issue, which relates to all five of the taxable years involved, concerns the time when taxpayer, an accrual basis taxpayer, should have included in gross income the dues received from members. Since taxpayer's right to receive these dues became fixed in the same years in which they were received, the accrual method of accounting requires inclusion of them in gross income for those years. More important here, however, than the particular accounting method chosen is the statutory requirement that income be computed for tax purposes on an annual rather than a transactional basis. As a corollary to this rule of annual accounting, the principle has become well established that, where an item of gross income is received under a claim of right and without restriction as to its disposition, inclusion of that item in a taxpayer's gross income cannot be deferred beyond the year of receipt, regardless of whether the taxpayer uses the cash or the accrual method of accounting. Here, the membership dues received by taxpayer involved no sale of property, but rather represented payments in advance for such serv-

ices as members might wish to receive in the ensuing twelve months. It is immaterial that taxpayer might later incur expenses in rendering services to members who had paid their dues in a previous year. Under well-settled principles, therefore, the membership dues received by taxpayer under a claim of right and without restriction of any kind were required to be included in its gross income for the years in which such dues were received. As shown by recent experience in connection with the 1954 Code, any change in these well-settled principles should be left to Congress, which now has the matter under study.

ARGUMENT

I

A CORRECT RULING THAT AUTOMOBILE CLUBS WERE NOT TAX-EXEMPT AS SOCIAL CLUBS HAVING BEEN PUBLISHED IN 1943, THE COMMISSIONER IN 1945 PROPERLY REVOKED PRIOR ERRONEOUS RULINGS IN FAVOR OF TAXPAYER AND DIRECTED IT TO FILE TAX RETURNS FOR 1943 AND 1944

This issue⁵ relates to 1943 and 1944, the first two of the five taxable years here involved. At issue is the propriety of the Commissioner's action on July 16, 1945, when, in accordance with the published 1943 ruling that automobile clubs were not tax-exempt as social clubs, he (1) advised taxpayer of his determination that it was not tax-exempt, (2) revoked prior inconsistent rulings in favor of taxpayer, and (3)

⁵ Issue I in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue II in taxpayer's brief before this Court.

directed taxpayer to file tax returns (as distinguished from mere information returns) for 1943 and 1944.

The issue has been considerably narrowed by taxpayer's concession that it was not tax-exempt for 1945 and subsequent years (Br. 15). This concession in effect admits the correctness of the Commissioner's July 16, 1945, ruling (R. 67) that

you are not a club "organized and operated exclusively for pleasure, recreation and other nonprofitable purposes", within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections.

From this concession, compelled by the decided cases,* it necessarily follows (1) that taxpayer, whose purposes and activities remained substantially the same, was no more a tax-exempt corporation, within the meaning of Section 101 (9) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69), in 1943 and 1944 than it was in 1945, 1946, and 1947; (2) that the similar ruling published in 1943 was correct; and (3) that the prior rulings in taxpayer's favor were erroneous.

It remains to be decided whether in July 1945 the Commissioner could properly revoke these earlier erroneous rulings and require payment of taxes for

* *Chattanooga Auto. Club v. Commissioner*, 182 F. 2d 551 (C. A. 6th); *Warren Automobile Club v. Commissioner*, 182 F. 2d 551 (C. A. 6th); *Keystone Automobile Club v. Commissioner*, 181 F. 2d 402 (C. A. 3d); *Smyth v. California State Automobile Ass'n.*, 175 F. 2d 752 (C. A. 9th), certiorari denied, 338 U. S. 905; *Automobile Club of St. Paul v. Commissioner*, 12 T. C. 1152.

See also Treasury Regulations 111: 29-101 (9)-1 (Appendix, *infra*, pp. 75-76).

1943 and 1944. In discussing this question, we shall consider: first, the nature of the earlier rulings; second, the Commissioner's statutory authority to issue new rulings with retroactive application; and third, the manner in which the Commissioner exercised his statutory authority in this case.

A. THE PRIOR ERRONEOUS RULINGS MERELY ADVISED TAXPAYER THAT THE COMMISSIONER CONCURRED IN ITS CLAIM OF EXEMPTION.

In considering the nature of the earlier rulings issued in 1934 and 1938, it should be noted at the outset that Congress has never empowered the Commissioner to confer upon corporations a tax-exempt status or to excuse them from filing tax returns. Nor has Congress established broad standards with respect to these matters, leaving it to the Commissioner to prescribe in particular the conditions required to meet those standards or to determine conclusively whether such standards have been met in a particular case. Rather, Congress itself, by Section 101 of the Internal Revenue Code of 1939 and corresponding sections of earlier revenue acts,¹ has specified the conditions under which organizations are to enjoy a tax-exempt status. And, in Section 52 of the 1939 Code (Appendix, *infra*, pp. 67-68) and corresponding sections of

¹ Sec. 101, Revenue Act of 1938, c. 280, 52 Stat. 447, 480; Sec. 101, Revenue Act of 1936, c. 690, 49 Stat. 1648, 1673; Sec. 101, Revenue Act of 1934, c. 277, 48 Stat. 680, 700; Sec. 103, Revenue Act of 1932, c. 209, 47 Stat. 169, 193; Sec. 103, Revenue Act of 1928, c. 852, 45 Stat. 791, 812; Sec. 231, Revenue Act of 1926, c. 27, 44 Stat. 9, 39; Sec. 231, Revenue Act of 1924, c. 234, 43 Stat. 253, 282; Sec. 231, Revenue Act of 1921, c. 136, 42 Stat. 227, 253; Sec. 231, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1076; Sec. 11, Revenue Act of 1916, c. 463, 39 Stat. 756, 766.

earlier revenue acts,* Congress has required tax returns to be filed only by corporations "subject to taxation under this chapter." It is clear, therefore, that whether a corporation is or is not tax-exempt, or does or does not have a duty to file tax returns for any particular year, is not governed by the ruling made by the Commissioner. See *Southern Maryland Agricultural Fair Assn. v. Commissioner*, 40 B. T. A. 549.

It does not follow, of course, that the Commissioner, in view of his statutory duty to assess taxes due,⁹ has no obligation to seek sufficient information to satisfy himself that the applicable legislation confers a tax-exempt status and relief from filing tax returns upon any taxpayers claiming such privileges. In the performance of that function, the Commissioner promulgated Regulations requiring the submission of relevant material concerning claimed tax exemptions.¹⁰ These Regulations¹¹ did no more than provide what kind of

* Sec. 52, Revenue Act of 1938, c. 289, 52 Stat. 447, 476; Sec. 52, Revenue Act of 1936, c. 690, 49 Stat. 1648, 1670; Sec. 52, Revenue Act of 1934, c. 277, 48 Stat. 680, 697; Sec. 52, Revenue Act of 1932, c. 209, 47 Stat. 169, 188; Sec. 52, Revenue Act of 1928, c. 852, 45 Stat. 791, 808; Sec. 239, Revenue Act of 1926, c. 27, 44 Stat. 9, 45; Sec. 239, Revenue Act of 1924, c. 234, 43 Stat. 253, 267; Sec. 239, Revenue Act of 1921, c. 136, 42 Stat. 227, 259; Sec. 239, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081; Sec. 13, Revenue Act of 1916, c. 463, 39 Stat. 756, 770.

⁹ Section 3640 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 3640).

¹⁰ Section 62 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 62) confers authority on the Commissioner to make all necessary rules and regulations.

¹¹ Sections 29.101-1 and 29.101-2, Treasury Regulations 111 (Appendix, *infra*, pp. 70-75). Prior to the enactment of the Revenue Act of 1943, c. 63, 58 Stat. 21, these Regulations contained the following provision (Section 29.101-1):

showing would be required to convince the Commissioner that the particular statutory provisions invoked by taxpayer were applicable. The Regulations did not, and could not, mean that a taxpayer who had obtained a favorable ruling from the Commissioner under the Regulations was forever excused from paying taxes and from filing the returns for past years, even though it later appeared that the Commissioner's ruling was based on an erroneous construction of the statute. Conversely, the Regulations did not, and could not, mean that a taxpayer who had failed to comply with the Regulations was barred from any

"When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, * * * except that every organization exempt or claiming exemption under section 101 * * * (9) * * * shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *."

Section 117 of the Revenue Act of 1943, *supra* (which added Section 54 (f) of the Internal Revenue Code of 1939, Appendix, *infra*, pp. 68-69), not only made the filing of annual information returns by tax-exempt organizations a statutory duty but also required such organizations to "make such other returns" as might from time to time be prescribed. With respect to proof of exemption on or after January 1, 1943, Section 29.101-2 of the Regulations, as added by T. D. 5381, 1944 Cum. Bull. 188, 192, to conform with the Revenue Act of 1943, eliminated the above-quoted regulatory provision and added the following:

"Every organization which has established its right to exemption from tax whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of section 54 (f) and this section."

exemption or other privilege conferred by the statute. Thus, in *Savings Feature of Relief Dept. of B. & O. R. R. Co. v. Commissioner*, 32 B. T. A. 295, the Board of Tax Appeals, in holding a banking corporation to be tax-exempt although it had not complied with the Regulations, stated (pp. 305-306):

Authority for the provisions of the regulations relating to "Proof of exemption" must be found in the general authority granted in each revenue act to the Commissioner to make all needful rules and regulations for the enforcement of the provisions of the act. The revenue acts did not confine the exemption to those banks which might file proof of exemption with the Commissioner. * * * The Commissioner, in effect, says in these articles, that each organization claiming exemption, if it wants him to agree that it is exempt, must file proof of its exemption with him. The penalty for failure to comply seems to be that the Commissioner, if he has doubts of the exempt character of any organization, may assess the tax and put that organization to the trouble of proving elsewhere its right to exemption.

The Commissioner published his acquiescence in this decision in 1935, XIV-1 Cum. Bull. 18.¹² See also

¹² The instant record illustrates that in practice Internal Revenue Service also adhered to this interpretation of the Regulations. Accordingly, where, as here, an organization, believed to be tax-exempt, failed to comply with the Regulations for several years and subsequently requested and received a favorable exemption ruling, no attempt was made to penalize it for not having complied with the Regulations in earlier years, and it was treated as tax-exempt from the start rather than merely from the time it complied with the Regulations and obtained the favorable ruling.

Langstaff v. Lucas, 9 F. 2d 691, 693 (W. D. Ky.), affirmed *per curiam*, 13 F. 2d 1022 (C. A. 6th), certiorari denied, 273 U. S. 721.

The 1934 and 1938 rulings, issued in accordance with these Regulations, did no more than advise taxpayer that in the Commissioner's opinion, on the basis of the data submitted, the particular statutory provisions invoked by taxpayer did apply, and that, barring a change of circumstances, the Commissioner would ~~not~~ require additional data to convince him. The 1934 and 1938 rulings, then, were merely interpretive rulings expressing the Commissioner's concurrence in taxpayer's opinion that the applicable legislation excused it from paying taxes or filing tax returns. Plainly, if the rulings had been adverse to taxpayer, nothing would have prevented taxpayer from challenging the Commissioner's position in the courts.

Noteworthy, too, is the nature of the error involved in these earlier rulings. The Commissioner's error was not in finding the facts or in evaluating them. It was rather a pure error of law arising from an erroneous construction of the statute.¹³ Thus, as both the 1943 and 1945 rulings show (see *supra*, pp. 7-10), the error was due to the Commissioner's misinterpretation of the terms "club" and "other non-

¹³ This erroneous statutory construction was not embodied in any generally applicable regulation so that it could be said to have received congressional approval upon re-enactment of the statute without substantial change. The situation here, therefore, is not like that in *Helvering v. Reynolds Co.*, 306 U. S. 110, upon which taxpayer here relies. (Br. 62-63.) See *Eastman Kodak Co. v. United States*, 48 F. Supp. 357 (C. Cls.).

profitable purposes," as those terms are used in Section 101 (9) of the 1939 Code and corresponding sections of earlier revenue acts.¹⁴ The nature of this error is significant in that it resulted in the Commissioner's failure to assess and collect taxes imposed by Congress in accordance with his statutory mandate.¹⁵ Having ascertained this error in the earlier rulings, it was incumbent upon the Commissioner to issue a new ruling to correct it. And, in the absence of some statutory prohibition, it is difficult to see why the Commissioner's statutory duty did not require him to apply his corrective ruling retroactively, at least to 1943 when the Commissioner's new construction of the statute was publicly announced.¹⁶ As we shall show (*infra*, pp. 29-32), far from there being

¹⁴ These were also the grounds upon which the court decisions, cited in fn. 6 *supra*, p. 22, were based.

¹⁵ Taxpayer relies (Br. 53-58) on cases such as *H. S. D. Co. v. Kavanagh*, 191 F. 2d 831 (C. A. 6th); *Woodworth v. Kales*, 26 F. 2d 178 (C. A. 6th); and *Lesavoy Foundation v. Commissioner* 238 F. 2d 589 (C. A. 3d). But the correctness of those cases need not be considered here, since they hold only that the Commissioner must abide by earlier rulings in the exceptional circumstances involved there. So far as relevant here, they expressly recognize that the Commissioner necessarily has authority retroactively to revoke earlier rulings which either involved errors of law or are tainted by fraud. Among the other cases holding that the Commissioner may properly correct his own or his predecessor's mistakes in the computation of particular tax liabilities are: *Burnet v. Porter*, 283 U. S. 230; *Sweets Co. of America v. Commissioner*, 40 F. 2d 436 (C. A. 2d); *McIlhenny v. Commissioner*, 39 F. 2d 356 (C. A. 3d); *Knapp-Monarch Co. v. Commissioner*, 139 F. 2d 863 (C. A. 8th); and *Commissioner v. Newport Industries*, 121 F. 2d 655 (C. A. 7th).

¹⁶ See Magill, *Finality of Revenue Determinations*, 28 Col. L. Rev. 563.

any statutory prohibition, Congress has recognized that there might be successive determinations of a particular tax liability by those occupying the office of Commissioner, and, moreover, has expressly granted the Commissioner statutory authority for issuing new rulings with retroactive effect. As we shall also show (*infra*, pp. 33-37), the Commissioner properly exercised his statutory authority in this case.

B. UNDER SECTION 3791 (b) OF THE INTERNAL REVENUE CODE OF 1939, THE COMMISSIONER HAD DISCRETION TO APPLY CORRECTIVE RULINGS RETROACTIVELY

In enacting the various provisions of the 1939 Code and prior revenue acts, Congress did not proceed on the assumption that every Commissioner would be infallible in his interpretation of the revenue laws. Rather, Congress was aware that errors were inevitable and that there would necessarily be successive determinations of particular tax liabilities, either by the same Commissioner or by successive Commissioners. Thus, for example, in enacting the provisions with respect to the finality of closing agreements, contained in Section 3760 of the 1939 Code (26 U. S. C. 1952 ed., Sec. 3760) and corresponding sections of prior revenue acts, Congress recognized that cases might be reopened but for the application of those provisions.¹⁷ And the definition of a deficiency

¹⁷ In recommending enactment of the Revenue Act of 1921, c. 136, 42 Stat. 227, the Senate Committee on Finance explained the closing agreement provisions contained in Section 1312 of that Act, as follows (S. Rep. No. 275, 67th Cong., 1st Sess., pp. 31-32; 1939-1 Cum. Bull. (Part 2) 181, 204):

"Under the present method of procedure a taxpayer never knows when he is through, as a tax case may be opened at any time because of a change in ruling by the Treasury Depart-

contained in Section 271 of the 1939 Code (26 U. S. C. 1952 ed., Sec. 271), as well as in corresponding sections of prior revenue acts, clearly presupposed the possibility of previous determinations of particular tax liabilities."

Section 3791 (b) of the 1939 Code (Appendix, *infra*, p. 70) dispels any remaining doubt whether Congress intended to authorize the Commissioner (with the approval of the Secretary) to apply corrective rulings retroactively. That section provides:

Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

ment. It is believed that this provision will tend to promote expedition in the handling of tax cases and certainly in tax adjustment."

"Section 271 (a) of the Internal Revenue Code of 1939, as amended by Section 14 (a) of the Individual Income Tax Act of 1944; c. 210, 58 Stat. 231, 245, provided:

In General.—As used in this chapter in respect of a tax imposed by this chapter, 'deficiency' means the amount by which the tax imposed by this chapter exceeds the excess of—

"(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

"(2) the amount of rebates, as defined in subsection (b) (2), made." (Emphasis added.)

In *Helvering v. Reynolds Co.*, 306 U. S. 110, this Court, in construing the corresponding section of the Revenue Act of 1928,¹⁹ stated (p. 116):

It is clear from this provision that Congress intended to give to the Treasury power to correct misinterpretations, inaccuracies, or omissions in the regulations *and thereby to affect cases in which the taxpayer's liability had not been finally determined*, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. [Emphasis added.]

The provision involved in *Reynolds* related only to Treasury regulations and Treasury decisions, but the Revenue Act of 1934 (c. 277, 48 Stat. 680) broadened the Commissioner's authority under this provision to include rulings as well, and its language was incorporated without change in the Section 3791 (b) of the 1939 Code. Under the circumstances, to apply the quoted language in the *Reynolds* case to this situation it is clear from Section 3791 (b) that Congress intended to give the Treasury power to correct misrepresentations in rulings and thereby affect cases in which the taxpayer's liability had not been finally determined, unless in the judgment of

¹⁹ Section 605 of the Revenue Act of 1928, c. 852, 45 Stat. 791, 874, provided:

"Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"Sec. 1108 (a). (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

the Treasury, some good reason required that such alterations operate only prospectively.³⁰

In the case at bar, the Commissioner exercised this statutory authority in issuing his 1945 ruling which, in accordance with the published 1943 ruling, revoked the prior erroneous rulings in favor of taxpayer and required it to file tax returns for 1943 and 1944.

³⁰ In recommending enactment of the provisions of the Revenue Act of 1934 which became Section 3791 (b) of the 1939 Code, H. Rep. No. 704, 73d Cong., 2d Sess., p. 38 (1939-1 Cum. Bull. (Part 2) 554, 583) stated:

"The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury decisions amending prior regulations or Treasury decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury decision, whether or not it amends a prior regulation or Treasury decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury decisions to be applied without retroactive effect. *Regulations, Treasury decisions, and rulings which are merely interpretative of the statute, will normally have a universal application*, but in some cases the application of regulations, Treasury decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury decisions, and rulings with prospective effect only." (Emphasis added.)

S. Rep. No. 358, 73d Cong., 2d Sess., p. 48 (1939-1 Cum. Bull. (Part 2) 586, 623), is substantially the same. It is clear, therefore, that the purpose of Congress in enacting the provisions of 1939 Code Section 3791 (b) was not, as taxpayer contends (Br. 64), merely to prevent retroactivity rather than to confirm any right of the Commissioner to take retroactive action.

C. THE COMMISSIONER DID NOT ABUSE HIS DISCRETION IN THIS CASE

Not only did the taxpayer fail in its attempt to prove that the Commissioner acted arbitrarily or unfairly in exercising this statutory authority,²¹ but the record establishes precisely the contrary.

The principles upon which the Commissioner's ruling of July 16, 1945, was based had been announced in G. C. M. 23688, namely, that Section 101 (9) of the 1939 Code conferred a tax-exempt status only on those organizations which were characterized by a comingling of members, one with another, in fellowship, and which were organized and operated exclusively for pleasure, recreation and other *similar* non-profitable purposes. See Statement, *supra*, pp. 7-10. G. C. M. 23688, which ruled that the American Automobile Association was not tax-exempt and which revoked, or recommended revocation of, prior published rulings in favor of local automobile clubs, was published in the Internal Revenue Bulletin of July 11, 1943. Upon the publication of this ruling, it became necessary for the Commissioner to re-examine all of the cases in which local automobile clubs had previously obtained favorable *unpublished* rulings. And, in re-examining these cases, it was only fair that the Commissioner afford each club an opportunity to submit additional data in the light of G. C. M. 23688.²² Because of the number of such organizations

²¹ See *Austin Co. v. Commissioner*, 35 F. 2d 910 (C. A. 6th).

²² By the Commissioner's letter of May 12, 1945, taxpayer was afforded such an opportunity (R. 59-60). Taxpayer appears to have overlooked this in arguing (Br. 47) that the Commissioner directed it to file tax returns for 1943 and 1944 without any further inquiry as to the facts.

involved, it became apparent that, while new rulings might be issued in many cases before the end of 1943, the processing of all of the cases would take considerably longer. Yet, in the Commissioner's view, fairness required that all of the clubs, whether the favorable rulings which they had previously obtained were published or unpublished, be treated alike, *i. e.*, that they be required to start paying taxes as of the same time. Therefore, since G. C. M. 23688 had been issued and published in 1943, 1943 was selected as the starting point for the taxation of all of these clubs, as the Tax Court found (R. 155-156).

The taxpayer, which of course had the burden of proof in the Tax Court, also failed to prove that it did not in 1943 have actual, as well as constructive, notice of the ruling with respect to the American Automobile Association published in that year as G. C. M. 23688. The record shows that taxpayer was a member of the American Automobile Association and that during the period from 1943 to 1947 it paid that organization dues varying in amounts from approximately \$53,000 to approximately \$65,000 per year. (Schedule K, Exs. 13, 15, 17, 19, 20; R. 20, 182, 183, 185, 187, 189.) Nor can it be disputed that taxpayer was represented on the board of directors of the American Automobile Association during this period. Taxpayer did not attempt to establish that the board of directors of the American Automobile Association or its members did not discuss such an important matter as G. C. M. 23688 and the revocation of the prior ruling as to that association's exemption from a tax. Nor did taxpayer

offer any evidence to show that the American Automobile Association did not call to the attention of its local club members the fact that G. C. M. 23688 also revoked, or recommended revocation of, prior published exemption rulings in favor of local clubs. If taxpayer did have notice of G. C. M. 23688—and there is nothing in the record to the contrary—the 1945 ruling cannot even be said to be retroactive except in a limited technical sense; for, as taxpayer was well aware, its organization was factually indistinguishable, for exemption purposes, from the organizations involved in G. C. M. 23688.

In any event, taxpayer is in no position to maintain that the Commissioner acted inequitably in July 1945 when, after further consideration, he revoked prior erroneous rulings in favor of taxpayer and directed it to file tax returns for 1943 and 1944. Taxpayer's case is certainly not one of hardship, for, while the deficiencies found by the Tax Court for the years 1943 and 1944 totalled \$125,048 and \$120,492, respectively (R. 181-182), taxpayer's balance sheets and tax returns show that it had an earned surplus and undivided profits at the beginning of 1943 of \$920,193.84, at the beginning of 1944 of \$1,046,230.85, and at the beginning of 1945 of \$1,300,471.81 (Schedule L, Exs. 13, 15; R. 68B, 76, 89)."

²² Compare *Lesavoy Foundation v. Commissioner*, 238 F. 2d 589 (C. A. 3), where the court, in holding that the Commissioner under the particular circumstances presented there had abused his discretion in retroactively revoking an exemption ruling, pointed out that the Commissioner's assessment, if enforced, would wipe out the assets of the taxpayer in that case. The revo-

Taxpayer surely had no vested right in a wrong construction of the statute by the Commissioner. The measure by which taxes are imposed is that laid down in the statute, as correctly read and not as mistakenly interpreted by government officers. See *supra*, pp. 23-27. If, as seems clear, taxpayer could not have acquired the right to escape taxes or the right to fail to file tax returns by virtue of judicial decisions subsequently overruled, *a fortiori* it could not acquire such rights by virtue of Commissioners' opinions subsequently overruled.

Nor could the fact that taxpayer had not filed tax returns for 1943 and 1944 possibly have any effect upon the Commissioner's authority to revoke the prior exemption rulings and to direct taxpayer to file tax returns for those years at the time when the Commissioner took such action. Thus, when the Commissioner on July 16, 1945, revoked the earlier erroneous rulings and directed taxpayer to file tax returns for 1943 and 1944, he could quite properly have then assessed deficiencies for 1943 and 1944, even if taxpayer had previously filed tax returns for those years.²¹

cation in the *Lesavoy* case, it may also be noted, was made retroactive five years, in contrast with the two years in this case. There was, moreover, in *Lesavoy* no prior published ruling (such as the 1943 ruling in this case) expressly rejecting the basis of the claimed exemption. On the basis of the differences between the two cases, the Third Circuit in *Lesavoy* distinguished the instant case. See note 15, *supra*.

²¹ Under Section 53 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 53), taxpayer's tax returns for 1943 and 1944 were due on March 15, 1944, and March 15, 1945, re-

Indeed, taxpayer is hardly in a position to invoke the "equities" of the situation. Having been mistakenly allowed to escape taxes and the filing of tax returns for the period from 1916 through 1942, taxpayer is now claiming that it should also be allowed these unwarranted privileges for 1943 and 1944. It is, moreover, seeking privileges not accorded to other automobile clubs. The Commissioner, on the other hand, seeks only uniform application of the revenue laws, and the payment of taxes actually imposed by Congress.

II

ASSESSMENT OF THE DEFICIENCIES FOR 1943 AND 1944 WAS NOT BARRED BY THE STATUTE OF LIMITATIONS

This issue," which also relates only to the years 1943 and 1944, involves an alternative contention of taxpayer—namely, that assessment of any deficiencies for those years was barred by the statute of limitations before the Commissioner mailed his deficiency notice. (Br. 73-82.) Consideration of this contention requires a review of the sequence of events in the light of the applicable statutory provisions.

Section 275 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69) provides that taxes, such as are here involved, "shall be assessed *within three years after the return was filed.*" (Emphasis

respectively. Under Section 275 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69), assessment of any deficiency could be made within three years after such returns were filed.

" Issue II in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue III in taxpayer's brief before this Court.

added.) Section 276 (b) (Appendix, *infra*, p. 70) authorizes an extension of the time prescribed by Section 275 if, before the expiration of that time, both the Commissioner and the taxpayer consent in writing to assessment of a tax after such time. In that event, "the tax may be assessed at any time prior to the expiration of the period agreed upon" and, moreover, the agreed period may be further extended by subsequent written agreements made before expiration of the period previously agreed upon. Section 276 (a) (Appendix, *infra*, pp. 69-70) provides that in the case "of a failure to file a return the tax may be assessed * * * at any time."

Here, after receiving the Commissioner's ruling of July 16, 1945, the taxpayer, under protest, filed income and excess profits tax returns for 1943 and 1944 on October 22, 1945. Within three years after October 22, 1945, namely, on August 25, 1948, the parties entered into a written agreement allowing assessment on or before June 30, 1949. Before June 30, 1949, namely, on May 23, 1949, the parties entered into a further agreement providing that the taxes could be assessed on or before June 30, 1950. (Exs. C and D, R. 108, 112; R. 156-157.) Before June 30, 1950, namely, on February 20, 1950, the notice of deficiency forming the basis of this proceeding was mailed to the taxpayer.²⁶ Prior to October 22, 1945,

²⁶ After the mailing of the notice of deficiency and the filing of a petition for redetermination in the Tax Court, the running of the statute of limitations is suspended until after the decision of the Tax Court has become final. Sections 272 (a) and 277 of the Internal Revenue Code of 1939 (26 U. S. C. 1952, ed., Secs. 272 (a) and 277).

when taxpayer filed its tax returns for 1943 and 1944, taxpayer had merely filed annual information returns on Form 990 (*supra*, p. 10).

From the foregoing, it is clear that assessment of the deficiencies for 1943 and 1944 was not barred by the statute of limitations if the agreement of August 25, 1948, was timely. And the agreement was timely unless, as taxpayer contends (Br. 73-81), either (a) the statute started to run prior to the actual filing of tax returns on October 22, 1945, or (b) the annual information returns on Form 990 constituted tax returns for purposes of starting the statute running.

A. THE STATUTE OF LIMITATIONS DID NOT START TO RUN BEFORE
THE TAX RETURNS FOR 1943 AND 1944 WERE FILED

Citing *Balkan Nat. Ins. Co. v. Commissioner*, 101 F. 2d 75 (C. A. 2d), and *Stockstrom v. Commissioner*, 190 F. 2d 283 (C. A. D. C.), both decided by divided courts, taxpayer in effect argues that it would be inequitable to allow the Commissioner to rely upon the fact that no tax returns were filed for 1943 and 1944 prior to October 22, 1945. According to taxpayer, either it was under no duty to file such returns before that time or it was prevented from performing that duty by the Commissioner. (Br. 73-77.) This argument is grounded upon two erroneous assumptions.

First, it is assumed that the Commissioner could relieve taxpayer of any duty to file tax returns. But, as shown in Point I of our argument (*supra*, pp. 23-27), the Commissioner had no such power. Under the applicable statutory provisions, taxpayer conced-

edly was subject to taxation and was required to file tax returns. Nor was taxpayer's duty affected by the Commissioner's erroneous interpretation of the statutory provisions," for, as stated in *Schafer v. Helvering*, 83 F. 2d 317, 320 (C. A. D. C.), affirmed, 299 U. S. 171: "Whoever deals with the government does so with notice that no agent can, by neglect or acquiescence, commit it to an erroneous interpretation of the law." See also the decision, directly in point, of the Board of Tax Appeals in *Southern Maryland Agricultural Fair Assn. v. Commissioner*, 40 B. T. A. 549, 553, holding that "the [Commissioner's] erroneous ruling did not relieve the petitioner from filing the returns and paying the taxes as the statute provided, and it did not start the running of any statutory period of limitation."

Second, it is assumed that the taxpayer was ready and willing to file tax returns before October 22, 1945, and that the Commissioner either deprived it of the opportunity or prevented it from doing so. Such is clearly not the case. The record does not indicate either that taxpayer was willing to file tax returns when such returns were due or that it would have filed them even if it had not obtained favorable rulings

²⁷ It is perhaps noteworthy in this connection that the Commissioner's erroneous view of the law did not remain unchanged until October 22, 1945, when taxpayer actually filed tax returns for 1943 and 1944. Rather, G. C. M. 23688, *supra*, which revoked, or recommended revocation of, prior published rulings in favor of automobile clubs, was published on July 11, 1943, and the ruling of July 16, 1945, which revoked prior unpublished rulings in favor of taxpayer and directed it to file tax returns for 1943 and 1944, was issued more than three months before taxpayer actually filed its tax returns.

from the Commissioner. Rather, the record shows that the taxpayer was the moving party in the matter, that in 1934 and during 1937 and 1938 it repeatedly claimed an exempt status under the statute, and that it prepared and submitted evidence to the Commissioner in order to induce him (as it did) to issue the rulings in its favor.²⁸ The Government had not seized taxpayer's books and records or in any other way interfered with the filing of tax returns.

The most that can be said for taxpayer is that its initial failure to file was due to a mutual mistake of law. And, while the nature of that error may have been such as to excuse taxpayer from any penalty for late filing (since failure to file would not be due to willful neglect), surely the mere fact that the Commissioner at first shared taxpayer's mistaken view of the law should not affect the normal operation of the statute of limitations on assessment of deficiencies. Moreover, on July 16, 1945, long before the expiration of the three-year periods after March 15, 1944, and March 15, 1945, respectively, the Commissioner expressed his view in writing to the taxpayer that it was subject to taxation and was required to file tax returns for 1943 and 1944. There plainly is no basis

²⁸ Taxpayer's claim that it was tax-exempt and accordingly not required to file tax returns not only preceded (instead of resulted from) the Commissioner's erroneous rulings in its favor but also survived his July 1945 ruling that it was subject to taxation and required to file tax returns for 1943 and 1944. Thus, when taxpayer actually filed tax returns for those years it filed them under protest, and, until this case came on for hearing in the Tax Court, taxpayer contended that it was tax-exempt not only for 1943 and 1944, but also for the subsequent years in issue.

for any suggestion that taxpayer was lulled into believing that the Commissioner had dropped his claims for those years or that taxpayer was prejudiced in any other manner. On the contrary, it must be assumed that the parties, in signing the agreements of August 1948 and May 1949 extending the period within which the taxes might be assessed, intended an effective, not a futile, act. The purpose of the statute of limitations would not be effectuated by resort to the fiction of treating the taxpayer's tax returns as if they had been filed before their actual filing.

The Tax Court in its opinion correctly distinguished the *Balkan Nat. Ins. Co.* and the *Stockstrom* cases, upon which the taxpayer relies. In the *Balkan Nat. Ins. Co.* case (C. A. 2), *supra*, the court held (p. 78) that the Government, by seizing all of the taxpayer's records through the Alien Property Custodian and by denying taxpayer access to such records, had made it impossible for taxpayer to prepare and file a return of its 1918 income. In addition, the deficiency notice was not mailed to taxpayer in Bulgaria until 1934. Hence, under those circumstances, which obviously differ greatly from the facts here, the Court held that Section 276 (a) (Appendix, *infra*, pp. 69-70) did not apply since that taxpayer's failure to file a return was due to an impossibility created by the Government.

In the *Stockstrom* case (C. A. D. C.), *supra*, where gifts for 1938 were involved and the notice of deficiency was not sent until 1948, the court concluded that the purpose of the filing requirement was fulfilled although no return had been filed, since in 1941

the Government possessed all pertinent facts and the limitation period commenced to run at that time. Here, on the other hand, on March 15, 1944, and March 15, 1945, taxpayer was in full possession of its books and records and the Government was not in possession of sufficient information to enable it to file a return for the taxpayer. Besides, as already pointed out, long before the period of limitations had expired, if computed from those dates, namely, on July 16, 1945, the Commissioner expressly directed taxpayer to file returns. Like the facts of the *Balkan Nat. Ins. Co.* case, the facts of the *Stockstrom* case differ radically from those of the instant case.

B. THE ANNUAL INFORMATION RETURNS ON FORM 990 DID NOT CONSTITUTE TAX RETURNS

Assuming *arguendo* that the statute of limitations did not start to run before the actual filing of tax returns for 1943 and 1944 on October 22, 1945, taxpayer alternatively argues that the Forms 990 filed on August 12, 1944, and May 17, 1945, should be held to constitute such returns. (Br. 77-81.) This argument ignores the relationship between the filing of tax returns and the assessment of deficiencies, and misconceives the nature of the annual information returns on Form 990.

For the collection of its income and excess profits taxes, the United States relies largely upon a system of self-assessment. See *Commissioner v. Lane-Wells Co.*, 321 U. S. 219, 223. Thus, each taxpayer keeps his or its own records, and from those records prepares and submits, on the form prescribed for the

particular tax involved, the data required for computation and the initial computation of his (or its) tax liability. Under the circumstances, deficiency assessments by the Commissioner are chiefly of a supplemental nature, designed to correct errors in the initial computations. Until the taxpayer has submitted the necessary data, with the initial computation, the Commissioner is in no position to determine whether there should be a deficiency assessment. Accordingly, in directing in Section 275 (a) that any deficiency in income (and excess profits)²⁹ tax should be assessed within three years "after the return was filed," Congress quite clearly meant the return containing the data required for computation of the particular tax liability.

This conclusion appears to be implicit in *Commissioner v. Lane-Wells Co.*, *supra*. There, the taxpayer, a personal holding company, had, with respect to the income tax, filed a return for each year on Form 1120, but had, with respect to the surtax imposed on personal holding companies, failed to file a separate return on Form 1120H as required by Treasury Regulations. Distinguishing its prior decision in *German-town Trust Co. v. Commissioner*, 309 U. S. 304, on which taxpayer in the instant case relies (Br. 78-79),³⁰ this Court stated (321 U. S. at 222-224):

²⁹ Section 275 (a) refers specifically to income taxes, but by Section 729 (26 U. S. C. 1952 ed., Sec. 729) its provisions were also made applicable to the excess profits tax.

³⁰ As this Court recognized in its *Lane-Wells* opinion (see excerpt quoted *infra* in the text), the *German-town* case held no more than that a taxpayer could not be said to have filed no tax return where he submitted all of the data necessary

The taxpayer has not complied with this regulation. It says, however, that its regular corporation income tax return must be taken as an equivalent to the separate return, under our [*Germantown*] decision * * * both for starting the period of limitation and for avoiding the penalty. The taxpayer in the *Germantown* case filed a return on a wrong form. The return contained, however, "all of the data from which a tax could be computed and assessed although it did not purport to state any amount due as tax," and the Court said, "this defect falls short of rendering it no return whatever." 309 U. S. at 308, 310. There the only liability involved was for a Title I income tax, and the return was addressed to that liability, as to which the court held that it set the statute of limitations running. Here the taxpayer is under liabilities for two taxes and under an obligation to file two returns, and it says that one return addressed to but one of the liabilities answers the purpose of both.

for computation of the particular tax liability but submitted it on the wrong form. In that case, the trustee of a fund filed a fiduciary return which disclosed all the data from which the tax, treated as one imposed upon a corporation, could be computed, and attached a list of the beneficiaries of the fund and their shares of the income. These beneficiaries included in their individual returns their shares of the income. The Commissioner determined that the fund should be taxed as a corporation and, from the fiduciary return, prepared a substitute corporation return on Form 1120 and gave notice of a consequent tax deficiency. The Court held (p. 310): "It cannot be said that the petitioner, whether treated as a corporation or not, made no return of the tax imposed by the statute. Its return may have been incomplete in that it failed to compute a tax, but this defect falls short of rendering it no return whatever."

Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. *The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.* For such purposes the regulation requiring two separate returns for these taxes was a reasonable and valid one and the finding of the Board of Tax Appeals that the taxpayer is in default is correct. [Emphasis added.]

Accordingly, it was held that the filing of the ordinary income-tax returns did not start the statute of limitations against the surtax.

In this case, we are concerned with corporate income and excess profits tax liabilities. By Section 29.52-1 of Treasury Regulation 111 (Appendix, *infra*, p. 70), the Commissioner prescribed the form (Form 1120) upon which corporations should submit returns with respect to their income tax liability. By Section 35.729-1 of Treasury Regulations 112, the Commissioner also prescribed the form (Form 1121) upon which corporations should submit returns with respect to their excess profits tax liability. It is not disputed that those forms called for the data required for computation of the particular tax liabilities involved, and that they called for its submission "with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns

may be readily accomplished." It follows, therefore, that the returns which taxpayer filed on those forms on October 22, 1945, constituted the tax returns which started the running of the statute of limitations on assessment of income and excess profits tax deficiencies.

The returns which taxpayer filed on Form 990²¹ were special annual returns of information which many tax-exempt organizations were required to file pursuant to Section 54 (f) of the 1939 Code (Appendix, *infra*, pp. 68-69) and Section 29.101-2 of Treasury Regulations 111, as added by T. D. 5381, 1944 Cum. Bull. 188, 190-192 (Appendix, *infra*, pp. 72-75). They were not intended to, and did not furnish, the data required for computation of income or excess profits tax liabilities. Like the ordinary income tax returns in the *Lane-Wells* case, *supra*, taxpayer's Form 990 returns were insufficient to start the statute of limitations running.

Section 54 (f) was added to the 1939 Code by Section 117 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, 36. Its purpose in requiring the novel information return, as explained in the committee reports, was not to obtain the data necessary to compute income and excess profits tax liabilities, but rather to obtain information with a view to determining whether legislation should be framed subjecting to taxation certain tax-exempt corporations which were competing with other corporations which did not enjoy similar

²¹ Taxpayer's Form 990 returns were filed on August 12, 1944, and May 17, 1945.

privileges.³² 'H. Rept. No. 871, 78th Cong., 1st Sess., pp. 24-25 (1944 Cum. Bull. 901, 920); 'S. Rep. No. 627, 78th Cong., 1st Sess., p. 21 (1944 Cum. Bull. 973, 990).

Not only did taxpayer's returns on Form 990 fail to supply the data necessary for computation of the particular tax liabilities involved with the necessary "uniformity, completeness, and arrangement," but they did not, as the Tax Court found (R. 156), furnish certain essential data at all. Thus, examination of the Forms 990 filed by taxpayer shows that items of income and disbursement are given only in summary fashion (Ex. 21; R. 95-105). In contrast, the Forms 1120 and 1121 eventually filed by taxpayer for the years 1943 and 1944 (Exs. 13, 14, 15, 16; R. 70-94) contain, as required by the Commissioner, the appropriate information in complete detail."

Finally, in enacting subsequent legislation, Congress demonstrated its awareness that the filing of Form 990 returns was, in the absence of special legislation to the contrary, insufficient to start the statute of limitations

³² In view of this congressional purpose, there is no merit in taxpayer's apparent suggestion (Br. 81) that Form 990 should have been so drafted as to obtain the data necessary for computation of income and excess profits tax liabilities.

³³ For example, taxpayer's Form 990 returns failed to show claims for depreciation deductions or their details as required by Item 25 (R. 71, 84) and Schedule J (R. 86) of Forms 1120 and 1121. Similarly, income subject to excess profits tax constituted for the years in question an essential factor in the computation of both the income and excess profits tax (Item 38, R. 71; Item 8, R. 77; Item 39, R. 84; Item 8, R. 91), but the income subject to excess profits tax, in turn, depended in large part on the excess profits credit adjustment (R. 80-81, 93-94), with respect to which the returns on Form 990 afforded no information.

running. In Section 302 (b) of the Revenue Act of 1950 (c. 994, 64 Stat. 906, 954), which on its face is inapplicable here, Congress enacted such special legislation. The provision states:

(b) *Period of Limitations.*—In the case of an organization which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit, the filing of the information return required by section 4 (f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). * * * The provisions of this subsection shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950, (1) any amount of tax was assessed or paid, or (2) a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer. [Emphasis added.]

In this case, the Commissioner mailed the notice of deficiency prior to September 20, 1950, namely, on February 20, 1950. Therefore, as the Tax Court stated in *Danz v. Commissioner*, 18 T. C. 454, 465, affirmed, *sub nom. John Danz Charitable Trust v. Commissioner*, 231 F. 2d 673 (C. A. 9th), certiorari denied, 352 U. S. 828, the 1950 legislation "indicates clearly that returns required by section 54 (f) for taxable years beginning prior to January 1, 1951, were not intended to start the running of the

period of limitations provided in section 275 and it required an act of Congress to make them effective for that purpose under any circumstances." In any event, the 1950 legislation could not apply for there is not present here a taxpayer which would be exempt from tax were it not for the fact that it carried on a trade or business for profit; taxpayer was not entitled to an exempt status on other grounds as well (see *supra*, p. 22.) Thus, the taxpayer's reliance on its Forms 990 to start the statute running would be unavailable even as to taxable years after January 1, 1951.

III

THE AMOUNT OF MEMBERSHIP DUES PAID TO TAXPAYER WAS INCLUDIBLE IN ITS GROSS INCOME FOR THE TAXABLE YEARS IN WHICH SUCH DUES WERE RECEIVED

This issue,²⁴ which relates to all five of the taxable years here involved (1943 through 1947), concerns the time when taxpayer, on the basis of the accrual method of accounting, is required to include in its gross income the dues paid by its members.

An "active" member's dues, originally in the amount of \$10 per year and increased on October 1, 1946, to \$12 per year, were payable annually in advance. By paying such dues, the member became entitled during the ensuing twelve months to request and receive such services as taxpayer might make available to its members. The dues which taxpayer received were not segregated or restricted as to dis-

²⁴ Issue III in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue I in taxpayer's brief before this Court.

position, but were deposited in its general bank account.³⁵

It is not disputed that the entire amount of membership dues which taxpayer received was includible in its gross income at some time. Taxpayer, however, contends (Br. 23-38) that, although it was entitled to, and without restriction did, receive a member's entire annual dues in advance, it was not required, as an accrual-basis taxpayer, to include the amount of such dues in its gross income for the year of receipt because it had not at that time earned such dues by making available the services to which its members might be entitled. This contention, we submit, not only misconceives the nature of the accrual method of accounting, but also fails to recognize the requirements of the revenue laws that income for tax purposes must be computed on an annual rather than a transactional basis.

³⁵ Taxpayer did not in any year attempt to establish a reserve for estimated expenses to be incurred in rendering services to members during the following year, and this case does not present any question as to the time when items of deduction claimed by taxpayer should be allowed. In this respect, the case at bar differs from cases relied on by taxpayer (Br. 26, 39, 40), such as *United States v. Anderson*, 269 U. S. 422, which involved deduction of reserves for taxes; and *Hilinski v. Commissioner*, 237 F. 2d 703 (C. A. 6th), and *Schuessler v. Commissioner*, 230 F. 2d 722 (C. A. 5th), both of which also involved deduction of estimated expenses or of a reserve for future expenses. *Pacific Grape Products Co. v. Commissioner*, 219 F. 2d 862 (C. A. 9th), upon which taxpayer also relies (Br. 40), presented the question when a sale was consummated and also did not involve deferring accrual of items of gross income beyond the year of receipt.

A. INCLUSION OF THE MEMBERSHIP DUES IN GROSS INCOME FOR THE TAXABLE YEARS IN WHICH TAXPAYER BECAME ENTITLED TO AND DID RECEIVE THEM WAS IN ACCORDANCE WITH THE ACCRUAL METHOD OF ACCOUNTING

By Section 41 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 67), taxpayers generally were authorized (with exceptions not here relevant) to choose the accounting method by which they would keep their books and compute their income for tax purposes. The effect on gross income of choosing the accrual method, selected by taxpayer in the case at bar, was explained by this Court in *Spring City Co. v. Commissioner*, 292 U. S. 182, 184, as follows:

Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues.

Under well settled principles of tax law, therefore, it is the right to receive and not the right to retain an item of income which determines its includibility in gross income under the accrual method of accounting. *Brown v. Helvering*, 291 U. S. 193; *Spring City Co. v. Commissioner*, *supra*.

Since it is undisputed that the taxpayer in the case at bar not only received a year's membership dues in advance but also had a fixed right to receive them at that time, inclusion of the amount of such dues in gross income for the year of receipt was in accordance

with the accrual method of accounting for tax purposes.²⁶

B. IN VIEW OF THE REQUIREMENT OF THE REVENUE LAWS THAT INCOME BE COMPUTED ON AN ANNUAL RATHER THAN A TRANSACTIONAL BASIS, ACCRUAL OF THE MEMBERSHIP DUES AS GROSS INCOME COULD NOT BE DEFERRED BEYOND THE YEARS IN WHICH THEY WERE, UNDER A CLAIM OF RIGHT AND WITHOUT RESTRICTION, RECEIVED

More important here than the particular accounting method which taxpayer selected under Section 41 of the 1939 Code is the requirement of that section that every taxpayer, regardless of his accounting method, compute his income on the basis of an annual accounting period.²⁷ Since income is by its very nature a flow, rather than a static condition or object, the imposition of a tax upon income requires that points of time be fixed between which the income is to be

²⁶ Under the circumstances, the Commissioner is not, as taxpayer argues (Br. 23), "contending that it should have accounted for the membership dues on a cash rather than an accrual basis, but rather that it improperly treated the item of dues under the accrual method of accounting which it had selected. See *United States v. American Can Co.*, 280 U. S. 412. See also *Beacon Publishing Co. v. Commissioner*, 218 F. 2d 697 (C. A. 10th), upon which taxpayer relies (Br. 36-38).

²⁷ Section 42 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 67) also provides:

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

Since in the case at bar the taxpayer did not acquire a right to receive the membership dues prior to the years in which it actually received them, the qualifying portion of this provision is not significant here.

measured for tax purposes. Computation of income on such an annual basis is, as a general matter, essential both to assure the Government a regular and ascertainable production of revenue and to provide a system susceptible of practical operation. See *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 365. And since income-producing transactions often extend over a period of more than one year, the annual basis of accounting requires that the computation of income for tax purposes show the net result of all of the taxpayer's transactions *during the year* rather than the net result of any particular transaction which may extend beyond that period. As this Court stated in the *Sanford & Brooks* case *supra*, at pp. 363, 364-365:

All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. * * *

* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

If, instead of this system of annual accounting, a basis of finally ascertained results of particular transactions is to be substituted, Congress and not the courts must provide it. *Burnet v. Sanford & Brooks Co.*, *supra*, at p. 367.

This general principle of annual accounting has, in the absence of specific statutory exceptions²² or long-continued Treasury Regulations, been consistently applied by this Court. In the course of such application, two well-settled judicial doctrines have been adopted to insure that the niceties of commercial accounting do not prevent compliance with this important requirement that income tax for tax purposes be computed on an annual basis. These doctrines are the constructive receipt doctrine, which is not applicable here, and the claim of right doctrine, which, we submit, is both applicable and controlling here.

²² Examples of such special legislation in the Internal Revenue Code of 1939 are as follows: Section 43 (in cases of fixed liabilities payable in fixed installments over a series of years, deductions are allowed in a year other than that in which actually paid, as explained in *Security Mills Co. v. Commissioner*, 321 U. S. 281); Section 44 (installment basis income); Section 122 (net operating loss deduction); Section 127 (war losses); Section 128 (recovery of unconstitutional federal taxes); Section 162 (b) (division of tax burden between an estate and its beneficiaries); Section 3806 (mitigation of effect of renegotiation of war contracts or disallowance of reimbursement). See also exception expressly authorized in Treasury Regulations with respect to long-term contracts. *Burnet v. Sanford & Brooks Co.*, *supra*, p. 366, and Regulations 111, Section 29.42-4. These long-continued Regulations possess the force of law. *Bent v. Commissioner*, 56 F. 2d 99 (C. A. 9th). The same is true with respect to the Treasury Regulations treating bond premiums. Treasury Regulations 111, Section 29.22 (a)-17 (2) (a), to which taxpayer also refers in its brief (p. 42).

Under the constructive receipt doctrine, a cash basis taxpayer cannot avoid including in his gross income for the taxable year an item of gross income which he is then entitled to receive but which at his own election he does not then actually receive. Under the claim of right doctrine, neither a cash nor an accrual basis taxpayer can avoid including in his gross income for the taxable year an item of gross income which he has then actually received under a claim of right without restriction as to disposition, even though the right to receive the item may be disputed and even though eventually he may be able to retain only part or none of it. This doctrine was enunciated by this Court in *North American Oil v. Burnet*, 286 U. S. 417. There, in a unanimous opinion by Mr. Justice Brandeis income was held taxable in 1917, the year of receipt, even though the litigation on which the right to the money depended was still in progress and was not decided until 1922.”

” Pointing out (pp. 421-422, 423-424) that the taxpayer’s method of accounting was immaterial, the Court stated (p. 424) :

“The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. *If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.* * * * If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year.” (Emphasis added.)

The principle of the *North American* case has been repeatedly reaffirmed in subsequent decisions of this Court.⁴⁰ In *United States v. Lewis*, 340 U. S. 590, a

⁴⁰ This principle has also been applied in a variety of situations by the lower courts. Nor, since it is a corollary of the principles of annual accounting, is there, as taxpayer suggests (Br. 38), any less basis for its application where items of gross income are received under an undisputed rather than a disputed claim of right. Cases in which the principle has been applied where the right to the income was not in dispute include the following: *Blum v. Helvering*, 74 F. 2d 482 (C. A. D. C.), certiorari denied, 295 U. S. 732 (profits realized from stock sales, subject to the obligation to support market with a fund in a stated minimum amount by operating a trading pool for six months subsequent); *Fairmont Creamery Corp. v. Helvering*, 89 F. 2d 810 (C. A. D. C.) (interest received by corporation from employees to whom stock had been sold on credit, subject to refund in the event employee quit or was discharged); *Commissioner v. Lyon*, 97 F. 2d 70, 73-74 (C. A. 9th) (cash paid to lessor at beginning of ten-year term, subject to refund on termination of lease otherwise than by default of lessee); *First Nat. Bank v. Commissioner*, 107 F. 2d 141 (C. A. 6th) (proceeds of a note held taxable notwithstanding contingent liability to repay at maturity if maker failed or if purchase of certain corporate assets was not consummated); *Detroit Consolidated Theatres v. Commissioner*, 133 F. 2d 200 (C. A. 6th) (sum received as advance rental deposit); *South Dade Farms v. Commissioner*, 138 F. 2d 818 (C. A. 5th) (sum received as advance rentals); *Clay Sewer Pipe Ass'n. v. Commissioner*, 139 F. 2d 130 (C. A. 3d) (prepayment for services to be rendered, although under contract recipient may be liable subsequently to return their equivalent); *DeGuire v. Higgins*, 159 F. 2d 921 (C. A. 2d) (dividends payable to purchaser of stock subject to possible refund under contract terms); *Capital Warehouse Co. v. Commissioner*, 171 F. 2d 395 (C. A. 8th) (prepayment for services, whose cost taxpayer must defray in later year); *Haberkorn v. United States*, 173 F. 2d 587 (C. A. 6th) (bonus subsequently returned to employer because of error in calculation of profits, upon which the bonus was based); *Gilken Corp. v. Commissioner*, 176 F. 2d 141, 144-145 (C. A. 6th) (sums received as advance rental deposit, security for performance and part payment of purchase price should lessee exercise its option to purchase); *Booth Newspapers*

taxpayer had been mistakenly paid a bonus which he had not earned " and which he was subsequently required to return. Pointing out that "the 'claim of right' interpretation of the tax laws has long been used to give finality to that period, and is now deeply rooted in the federal tax system" (p. 592), the Court

✓ *Commissioner*, 201 F. 2d 55 (C. A. 6th) (sum received by cash basis taxpayer as prepaid subscription for newspapers to be delivered in succeeding year); *Gordon's Estate v. Commissioner*, 201 F. 2d 171 (C. A. 6th) (sum received under lease with privilege to purchase); *Hyde Park Realty v. Commissioner*, 211 F. 2d 462 (C. A. 2d) (sum received as advance rentals).

The decisions make it clear that the rule applies to accrual as well as cash basis taxpayers. See *North American Oil v. Burnet*, *supra*, pp. 421-422, 423-424; *id.*, 50 F. 2d 752, 755-756 (C. A. 9th); *Brown v. Helvering*, 291 U. S. 193, 199-200; *Clay Sewer Pipe Assn. v. Commissioner*, *supra*, p. 132; *South Dade Farms v. Commissioner*, 138 F. 2d 818 (C. A. 5th).

"That the includibility of earnings in gross income depends upon the right to receive them or their actual receipt, rather than the time when they were earned, was explained by this Court in *Guaranty Trust Co. v. Commissioner*, 303 U. S. 493, 494, 498, as follows:

"It is true that the acts of Congress taxing income have consistently laid the tax upon the net income received by or accrued to the taxpayer in a 'taxable year,' which is either the calendar year or a different fiscal year, as the taxpayer may elect. But they have never undertaken to limit the income taxable in any one year to that derived from the taxpayer's activities occurring in that or any other single year. The items of gross income and of allowed deductions to be included in the income return, are those of the taxpayer for his taxable year, even though they may have resulted from or be affected by his business transactions of other years. *Burnet v. Sanford & Brooks Co.*, *supra*, * * *. Circumstances wholly fortuitous may determine the year in which income, whenever earned, is taxable, and may thus affect the amount of tax. Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it nor the duration of his investments which have finally resulted in profit."

held that the amount of the bonus was includible in gross income for the year of receipt. In *Brown v. Helvering*, 291 U. S. 193, a taxpayer as general agent for fire insurance companies had received overriding commissions on policies sold subject to a contingent liability to refund a proportionate part of the commissions in the event of subsequent cancellations or reinsurance. This Court held that the entire amount of the overriding commissions was required to be accrued as gross income for the year of receipt, since "[w]hen received, the general agent's right to it was absolute. It was under no restriction contractual or otherwise, as to its disposition, use or enjoyment" (p. 199). In *Heiner v. Mellon*, 304 U. S. 271, this Court, holding taxable to partners their distributive shares of profits earned in the liquidation of a business, pointed out (p. 275) that it was of no legal significance that the liquidation was not completed until a subsequent year and that until completion it could not be known whether the business venture taken as a whole had been profitable. In *Security Mills Co. v. Commissioner*, 321 U. S. 281, 284, the amount of a processing tax received as part of the cost of goods sold (and treated as such in determining the amount to be taken into gross income from the sales) was held to constitute income in the year of receipt, even though the validity of the tax was then in dispute and the tax was in later years returned to the purchasers. This Court rejected taxpayer's contention, which would have (pp. 285-286) "upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due

on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system * * *." See also *Healy v. Commissioner*, 345 U. S. 278.

Such decisions firmly establish the proposition that, where an income-producing transaction results in the receipt of an item of income under a claim of right and without restriction as to its disposition, inclusion of the item in gross income for tax purposes is not to be deferred beyond the year of receipt merely because the continuing nature of the transaction requires that in a subsequent period either (a) services be rendered or the use of property be allowed, or (b) expenses be incurred or a portion of the income be returned. In the case at bar, the membership dues paid to taxpayer were received under a claim of right and without restriction as to their disposition. Accordingly, the annual basis of computing income requires that the amount of such dues be included in taxpayer's gross income for the year of receipt, notwithstanding that in a subsequent period it might have to incur expenses in rendering services to members.⁴²

Beacon Publishing Co. v. Commissioner, 218 F. 2d 697 (C. A. 10th), upon which taxpayer relies (Br. 36-

⁴² Taxpayer appears to have abandoned in this Court any contention that the accrual into income of the dues received should be deferred because of the alleged possibility that a small amount might be refunded in the succeeding year because of cancellation of membership. Such alleged liability was contingent in obligation and unsettled in amount and no event necessary for its accrual occurred in the taxable year. See Statement, *supra*, p. 12; *Brown v. Helvering*, *supra*.

38), was decided by a divided court subsequent to the Tax Court's decision⁴³ but prior to the decision by the Court of Appeals below. With deference, we submit that the majority opinion there is in error and Judge Bratton's dissenting opinion expresses the correct view. The reasoning of the majority, it would appear, is inconsistent with the rule which, as the cases cited above demonstrate, this Court and the lower courts have repeatedly followed—namely, that taxable income under the statute is not limited to income computed on a basis of the final outcome of given transactions, save in those special situations where the statute or long-continued Treasury Regulations have made express exceptions.

In any event, the factual situations here and in the *Beacon Publishing Co.* case are distinguishable. There the disputed payments were received by the taxpayer in consideration for newspapers to be delivered in future years, *i. e.*, as payment for a commodity. The cost of goods sold normally reduces the amount of gross receipts taken into gross income from a sale. Internal Revenue Code of 1939, Section 111 (a). In the instant case, on the other hand, the amounts received were in payment for services, the expense of which would normally not reduce the amount of gross receipts to be taken into gross income but would rather be deductible from gross income in arriving at net income. There was also present in the *Beacon Publishing Co.* case an administrative ruling which

⁴³ However, in a later case, the Tax Court has adhered to its decision in the instant case, and expressed agreement with Judge Bratton's dissent in the *Beacon Publishing Co.* case. *Andrews v. Commissioner*, 23 T. C. 1026, 1033.

lent possible support to taxpayer. In L. T. 3369, 1940-1 Cum. Bull. 46, the Internal Revenue Service, recognizing that there were two methods by which accrual basis publishers had been accounting for prepaid subscriptions, had ruled that where a publisher "over a period of years" had reported an aliquot part of the subscription income over the subscription period, it would be permitted to continue to report the income in that manner and would not be required to change this accounting practice, provided that expenses applicable to obtaining the subscriptions were similarly allocated in the subscription period. Publishers who had been reporting the subscription income when received (see G. C. M. 20021, 1938-1 Cum. Bull. 157) were to continue to report the income in that manner. By contrast, no administrative authority in support of taxpayer's position here may be claimed. Again, here the expense of services to a given member might be incurred substantially in the first month of membership, i. e., for emergency road service and travel information; in *Beacon Publishing Co.*, on the other hand, the newspapers would be published daily on a regular basis throughout the subscription period.

Finally, the action of Congress in enacting Sections 452 and 462 of the Internal Revenue Code of 1954 (26 U. S. C. 1952 ed., Supp. II, Secs. 452 and 462) and in subsequently repealing those sections makes clear the correctness of the Commissioner's position here under Sections 41 and 42 (a) of the Internal Revenue Code of 1939. In Sections 452 and 462 of the 1954 Code, Congress enacted exceptions to the

general requirement that income be computed for tax purposes on an annual rather than a transactional basis. This was done by permitting taxpayers, at their election, to postpone the reporting of prepaid income and to establish reserves for estimated expenses. That Congress intended these provisions to represent a change in the law with respect to the tax treatment of advance payments for services to be rendered is made clear by the report of the Senate Committee on Finance, which states (S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 62-63; 3 U. S. C. Cong. & Adm. News (1954) 4629, 4694):

Under present law payments received in advance for the use of property in future years or for services to be rendered in future years are includible in the income of the recipient in the year they are received. This is true regardless of the taxpayer's method of accounting. However, well-established accounting procedure provides that in the case of those on an accrual accounting system payments for rentals, club dues, warehouse fees, and the like should be included in income for the year in which income is earned and in the year in which the related

"The Senate Finance Committee also referred to the type of problem presented in the *Beacon Publishing Co.* case and this case as follows (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 301; 3 U. S. C. Cong. & Adm. News (1954), 4629, 4940):

"Under the 1939 Code, regardless of the method of accounting, with minor exceptions established by regulations or administrative practice, amounts are includible in gross income by the recipient not later than the time of receipt if they are subject to free and nonrestricted use by the taxpayer. *even though the payments are for goods or services to be provided by the taxpayer at a future time.*" (Emphasis added.)

expenses are incurred. This is not necessarily the year of receipt.

The House and your committee's bill permit accrual-basis taxpayers to defer the reporting of advance payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned. [Emphasis added.]

The loss of revenue as the result of the enactment of Sections 452 and 462 of the 1954 Code was found to be so serious that, at the instance of the Treasury Department, those sections were repealed by the Act of June 15, 1955, c. 143, 69 Stat. 134.

Thereafter, the Secretary of the Treasury wrote the Chairman of the Committee on Ways and Means that the repeal of Section 452 would not be considered by the Department as either the acceptance or the rejection by Congress of the *Beacon Publishing Co.* decision or any other judicial decisions." In short, the recognized effect of the repeal was to restore prior law. The committees of both Houses indicated that the subject was to be studied further with a view to

"H. Rep. No. 293, 84th Cong., 1st Sess., pp. 4-5 (1955-2 Cum. Bull. 852, 855):

"Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

legislation at an early date." Certainly this recent experience in dealing with these complex problems emphasizes the wisdom of leaving to Congress the decision of providing for exceptions to the settled annual accounting principle and claim of right doctrine."

* S. Rep. No. 372, 84th Cong., 1st Sess., p. 6 (1955-2 Cum. Bull. 858, 861) declared:

"Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles. Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed."

H. Rep. No. 293, 84th Cong., 1st Sess., p. 4 (1955-2 Cum. Bull. 852, 854) stated:

"In view of the testimony received from taxpayers by your committee and the recognized desirability of conforming tax accounting to business accounting, your committee has instructed the staff of the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation to make studies of these accounting problems in an effort to provide conformance of tax and business accounting without the transitional revenue loss. It has further requested each staff to report any suggested solutions to the committee as soon as feasible."

"The understanding by Congress that a change in the settled rules in this field should be made by legislation is supported by its enactment of Section 1341 of the Internal Reve-

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Appeals is correct and should be affirmed.

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nue Code of 1954 (26 U. S. C. 1952 ed., Supp. II, Sec. 1841). The detailed terms of this section further demonstrate the wisdom for provision to be made by legislative action.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687, 697] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U. S. C. 1952 ed., Sec. 42.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for

the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *

(26 U. S. C. 1952 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To Determine Liability to Tax.*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

(f) [As added by Sec. 117 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, 36] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render

under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may, from time to time prescribe. * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

(9) Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

(26 U. S. C. 1952 ed., Sec. 101.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court

for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver*.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 3791. RULES AND REGULATIONS.

(b) *Retroactivity of Regulations or Rulings*.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U. S. C. 1952 ed., Sec. 3791.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.52-1. *Corporation Returns*.—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. * * *

SEC. 29.101-1 [As amended by T. D. 5381, 1944 Cum. Bull. 188, 189] *Proof of Exemption Prior to January 1, 1943.—Annual Returns for Accounting Periods Beginning Prior to Janu-*

ary 1, 1943.—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption * * * under section 101 (9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation * * *

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information speci-

fied herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

SEC. 29.101-2 [As added by T. D. 5381, *supra*]. *Proof of Exemption on or after January 1, 1943.—Annual Returns for Accounting Periods Beginning on or After January 1, 1943.—(a) Proof of exemption.—An*

organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of affidavit or questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any collector: For organizations claiming exemption * * * under section 101 (9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

(b) * * *

In addition to the information specifically called for by these regulations the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

(c) *Collector's duties with respect to proof of exemption.*—The collector, upon receipt of the affidavit or questionnaire and other papers constituting the proof of exemption by an organization claiming exemption from tax under section 101, will forward completed documents to the Commissioner for decision as to whether the organization is exempt.

* * * *

(e) *Requirement of annual returns.*—For accounting periods beginning after December 31, 1942, every organization exempt from tax under section 101, regardless of the amount or source of its income or receipts and irrespective of whether it is chartered by, or affiliated or associated with, any central, parent, or other organization, except organizations specifically exempted from filing annual returns by section 54 (f) (see subsection (h) of this section), shall file annually with the collector for the district in which is located the principal place of business or principal office of the organization a return of information on Form 990 (revised May, 1944) specifically stating the items of gross income, receipts, and disbursements and such other information as may be prescribed by the Commissioner in the instructions on the form or issued by him therewith. * * *

* * * *

(g) *Date for filing annual returns.*—The annual return of information, Form 990 (revised May, 1944), for accounting periods beginning after December 31, 1942, but ending prior to April 1, 1944, shall be filed on or before August 15, 1944, and for accounting periods beginning after December 31, 1942, but ending after March 31, 1944, shall be filed on or before the 15th day of the fifth full calendar month following the close of the period for which the return is required to be filed.

* * * *

(i) *Collector's records.*—Collectors will keep a list of all organizations held to be exempt from tax to the end that they may occasionally inquire into their status and ascertain whether or not they are (1) observing the conditions upon which their exemption is predicated, and (2) annually filing returns on Form 990 (revised May, 1944) if they are required to file such returns.

(j) *Records, statements, and other returns of tax-exempt organizations.*—An organization which has established its right to exemption from tax under section 101 and has also established that it is not required to file annually the return of information on Form 990 (revised May, 1944) shall immediately notify in writing the collector for the district in which is located its principal office of any changes in its character, operations, or purpose for which it was originally created.

Every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of section 54 (f) and this section. For requirement as to keeping of permanent books of account or records, see section 29.54-1.

An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54 (f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the duty of filing other returns of information (see sections 147 and 148).

Sec. 29.101 (9)-1. *Social Clubs.*—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and

assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

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JOHN T. FEY, Clerk

IN THE
Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING

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**TO THE HONORABLE THE CHIEF JUSTICE OF THE
UNITED STATES AND THE ASSOCIATE JUSTICES
OF THE SUPREME COURT OF THE UNITED STATES:**

Petitioner, Automobile Club of Michigan, respectfully prays that this Court grant a rehearing of its decision of April 22, 1957, insofar as the decision held that the Commissioner could properly tax prepaid membership dues in the year of receipt rather than when the membership dues were earned.

A rehearing is not requested on the other issues in the case.

GROUNDS FOR REHEARING

I. The majority decision on the issue of prepaid dues is based upon a statement of facts for which there is no support in the record. The facts stated in the majority opinion are simply not the facts of the case.

II. The dissenting opinion of Mr. Justice Harlan, concurred in by Mr. Justice Burton and Mr. Justice Clark, correctly construes section 41 of the Internal Revenue Code of 1939.

The majority decision is in error in holding that section 41 vests the Commissioner with the discretionary right to disapprove a method of accounting which *concededly* more clearly reflects income than the method which the Commissioner would substitute.

Moreover, the Commissioner did not reject petitioner's accounting method on the discretionary ground stated in the majority decision. His position was based solely on an erroneous point of law—that the "claim of right" doctrine compelled a change in petitioner's accounting method.

III. If the majority decision is allowed to stand, the Commissioner's power to reject accounting methods will be virtually beyond the control of the courts, and taxpayers will be harrassed on a scale heretofore unknown.

IV. The majority decision unnecessarily invites litigation on issues involving prepaid income.

I.

Before the Tax Court and the 6th Circuit Court of Appeals, the Commissioner contended that the "claim of right" doctrine required the rejection of petition-

er's method of accounting for prepaid dues, and both Courts sustained the Commissioner solely on that ground. Before this Court the Commissioner again urged the "claim of right" doctrine as controlling (Resp. Br. 56-60). Quite properly, this Court refused to hold that the "claim of right" doctrine was applicable to the prepaid dues in petitioner's case.

Instead, the majority decision held that the Commissioner, in the circumstances of petitioner's case, did not abuse his discretion in determining whether the petitioner's method of accounting clearly reflected income.¹ The asserted "circumstances", on which the Court based its conclusion, were stated in the opinion (p. 9):

"The pro rata allocation of the membership dues in monthly amounts is purely artificial and bears no relation to the services which petitioner may in fact be called upon to render for the member."

In a footnote to the preceding sentence, the opinion stated (p. 9):

"In this case, *substantially all* services are performed only upon a member's demand and the taxpayer's performance was not related to fixed dates after the tax year." (Emphasis supplied.)

¹ This Court stated. (p. 9): "We cannot find, in the circumstances here, that the discretionary action of the Commissioner, sustained by both the Tax Court and the Court of Appeals, exceeded permissible limits": Neither the Tax Court nor the Court of Appeals considered the ground adopted by this Court. Both of the lower Courts relied on the "claim of right" decisions, and neither Court suggested that if the Commissioner was wrong on his "claim of right" argument he would nevertheless have had the right to reject petitioner's method of accounting.

Petitioner respectfully submits that the record utterly fails to support the statement made by the Court in the footnote; that the record clearly establishes that the facts are to the contrary; and that petitioner's method of accounting—rather than being “purely artificial”—related in a most reasonable manner the time when the expenses of earning the dues occurred with the time the dues were returned by petitioner as income.

The undisputed fact is that the greater part of petitioner's expenses in performing its obligations to its members was not incurred “upon a member's demand”. The record shows that the expenses incurred “upon a member's demand” were less than one-third of petitioner's expenses in discharging its obligations to the members.²

Using the year 1943 as an example, out of the total expenses in excess of \$1,900,000 (R. 71) only \$548,364.58 (R. 182) was spent for emergency road service. The emergency road service (rendered by independent garages, but paid for by petitioner) is the service rendered “upon a member's demand”. A greater amount, more than \$577,000 (R. 71), was spent in the year 1943 simply for salaries and wages of officers and employees—fixed expenses incurred in earning the annual dues. The expense, for example, of keeping a staff of telephone operators constantly on duty to accept calls for road service was necessarily incurred whether or not a particular member had an occasion to call for service.

² Among the obligations incurred upon receipt of dues from a member was the obligation to furnish him for a period of one year, without further charge, 12 issues of the “Motor News”, a magazine published monthly by petitioner.

It is obvious that the Court was in error in assuming that the timing of substantially all the expenses incurred in earning the dues income was dependent upon the timing of the member's demand for services. The present record adequately establishes the Court's error. But if there is any doubt on this score the case should be remanded to the trial court for findings of fact on this issue, particularly since this Court attempted, on the basis of facts, to distinguish petitioner's case from *Beacon Publishing Co. v. Commissioner*, 218 F. 2d 697 and *Schuessler v. Commissioner*, 230 F. 2d 722.

The Court's assertion that the allocation of the membership dues was "purely artificial" and bore no relation to the services rendered is unfounded even if it were assumed that substantially all expenses were incurred only upon demand of the members. If petitioner were rendering services for but a single member, it might be artificial to keep books on the assumption that each month petitioner would incur 1/12 of the expenses in earning the 12 months dues. But any such artificiality completely disappears on giving a moment's thought to the fact that petitioner was rendering services to more than 200,000 members each year.*

Petitioner was entitled to keep its books with due regard to the leveling results of the law of averages. Certainly, in the case of 20,000 membership dues paid in December 1943, it was not "purely artificial" for the petitioner to keep its books on the premise that 11/12 of the emergency calls from those members, be-

* The number of members paying dues to petitioner ranged from a low of 212,865 in 1943 to a high of 261,695 in 1946. (R. 21)

cause of battery failures, flat tires, and the like, would occur in 1944.⁴

Petitioner's method of accounting was not designed, as the Court's opinion seems to assume, to determine the profit or loss on any particular membership account. The accounting method—adopted when petitioner was exempt from taxation—was designed for, and reasonably serves, the purpose of matching the income from dues earned in one year with the related expenses. Rather than being “purely artificial”, as the majority decision erroneously assumed, petitioner's method conforms to generally accepted accounting principles. In the Handbook of Accounting Methods (1943 edition, edited by J. K. Lasser), the proper accounting method for dues received by clubs is stated (p. 517):

“Where dues are payable yearly in advance, and monthly income and expense statements are prepared, the proportionate amounts of dues receivable for the month should be taken into income, and the unearned balance should be shown on the balance sheet as deferred income.”

In the third edition (1943) of the Accountant's Handbook, edited by W. A. Patton, it is stated (p. 114):

“Advances by the customer or the client are perhaps more common in the case of services than in the case of sale of goods * * *. Collections on account of services to be furnished in subsequent periods should, of course, be excluded from current revenue.”

⁴ To say that petitioner's method of accounting for dues paid by more than 200,000 members is “purely artificial” is as fallacious as to say that a life insurance company should not be allowed to deduct, with respect to a premium received during the year on a particular policy, a reserve based on average expectancies.

II.

Mr. Justice Harlan in his dissenting opinion, concurred in by Mr. Justice Burton and Mr. Justice Clark, states (p. 3) that he does not understand the majority decision since "the Commissioner does not deny—as, indeed he could not—that the method of accounting used by the taxpayer reflects its net earnings with considerably greater accuracy than the method he proposes". Mr. Justice Harlan's inability to understand is shared by petitioner, and the lower courts might well experience the same difficulty.

The Commissioner rejected petitioner's accounting method solely because he took the position that the "claim of right" doctrine was controlling. He was wrong on that, but under the majority opinion the Commissioner nevertheless had the discretionary right to cast aside petitioner's accounting method and substitute a method which—without dispute—reflected net income less accurately, since the Court (but not the Commissioner) viewed petitioner's method as "purely artificial".

There is no reason to believe that the Commissioner, if he had known at the commencement of these proceedings that his "claim of right" argument was invalid, would nevertheless have refused to accept petitioner's method of accounting. The Commissioner has never contended that petitioner's method was "purely artificial"—his position was that it was immaterial (Resp. Br. p. 60) that the expenses of earning the dues would be incurred in part after the year of the receipt of the dues.

It is submitted, with the greatest of deference, that the majority decision on this issue is erroneous. In

the first place, section 41 does not say—and it is beyond comprehension to believe that Congress intended—that if the Commissioner finds any defect in the taxpayer's method of accounting, then the Commissioner has the uncontrolled right to substitute another method of accounting even though that method concededly reflects income less accurately. In the second place, if any such discretionary power exists in the Commissioner, the Commissioner, and not the Court, ought to exercise the discretion initially.

III.

Judges—as well as taxpayers—have complained that the Commissioner's practice of substituting his accounting method for the taxpayer's method has exceeded all reasonable bounds. Judge Opper, in a dissenting opinion concurred in by five other Judges of the Tax Court, made the following comment in the case of *Pacific Grape Products v. Commissioner*, 17 T.C. 1097, 1110 (reversed by 9th Cir. 219 F. 2d 862):

"The practice of disapproving consistent accounting systems of long standing seems to me to be exceeding all reasonable bounds. * * * Methods of keeping records do not spring in glittering perfection from some unchangeable law but are devised to aid businessmen in maintaining sometimes intricate accounts. * * *

"It will not do to say that respondent should not have disturbed petitioner's accounting method, but that since he has done so, we are powerless to do otherwise. As long as we continue to approve the imposition of theoretical criteria in so purely practical a field, respondent will go on attempting to seize on such recurring fortuitous occasions to increase the revenue, * * *

The 9th Circuit, in denying the Commissioner the right to reject the taxpayer's method of accounting in that case, referred with approval, in reversing the Tax Court, to the dissenting opinion of Judge Oppen. Now it appears that no court will have the right to so repudiate the Commissioner, if the majority decision stands in petitioner's case.

Under the majority decision, the Commissioner has an uncontrolled discretion to reject a taxpayer's accounting method if the taxpayer's method is subject to criticism, and the Commissioner's method must be used even though it reflects income less accurately than the taxpayer's method. The only defense left to the taxpayer is to prove that his method is "glittering perfection" to use Judge Oppen's expression. That is an impossible burden for the taxpayer to bear. No method of accounting can meet the test of perfection, and certainly every method of accounting is subject to the charge of some artificiality.

The lack of perfection in an accounting method is never a serious matter if the method used is consistently applied from year to year. But it is a serious matter if lack of perfection gives the Commissioner the right, *carte blanche*, to reject that method and substitute his own method without any showing that his method is superior to the disapproved method.

This new power given to the Commissioner under the majority decision cannot fail to produce harassment of taxpayers on a scale not heretofore known. If the decision stands, the Commissioner's power to reject a taxpayer's method of accounting is, for all practical purposes, completely beyond the control of the courts.

IV.

Petitioner assumed, and believes, that this Court granted certiorari on the dues issue because of the conflict of the decision below with the decision of the Court of Appeals for the 10th Circuit in *Beacon Publishing Co. v. Commissioner*, supra, and with the decision of the Court of Appeals for the 5th Circuit in *Schuessler v. Commissioner*, supra.

This Court did not resolve the conflict because it stated that petitioner's case is distinguishable on its facts from *Beacon* and *Schuessler*. As already pointed out in this petition, this statement of the Court was due to a misunderstanding of the facts in petitioner's case.

In its opinion (p. 9) this Court stated that it expressed no opinion as to the correctness of the decisions in *Beacon* and *Schuessler*. As a result, taxpayers who believe their cases are factually similar to the *Beacon* or *Schuessler* case will continue to resist the attempt of the Commissioner to reject their accounting methods, and no doubt the Commissioner, in the light of this Court's opinion in petitioner's case, will continue to reject their accounting methods. If the taxpayer is in the 5th, 9th, or 10th Circuit, he will be allowed to retain his accounting method if his facts are similar to *Beacon* or *Schuessler*, but a taxpayer with the same facts in the 6th Circuit would lose. The result in other circuits will depend on future litigation, invited by this Court's opinion in petitioner's case.

The failure of this Court to resolve the conflict can be corrected by the granting of this petition for rehearing.

CONCLUSION

For the reasons hereinabove set forth it is respectfully requested that this petition for rehearing be granted in the interests of justice and good tax administration.

Respectfully submitted,

RAYMOND H. BERRY,
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JOHN L. KING,
Attorneys for the Petitioner.

Of Counsel:

ELLSWORTH C. ALVORD,
LINCOLN ARNOLD.

Dated: May 16, 1957.

Certificate of Counsel

We, Raymond H. Berry and Ellsworth C. Alvord, counsel for the above named petitioner, do hereby certify that the foregoing Petition for Rehearing of this cause is presented in good faith and not for delay.

RAYMOND H. BERRY
ELLSWORTH C. ALVORD

Dated: Washington, D. C.
May 16, 1957.